# State Taxes on Aviation

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Caveat: The state laws, regulations and cases referred to in this article and in the examples are offered for purposes of illustration only. They may not represent the current law in that state.

1. State Tax Problems and Myths

1.01. State Tax Problems

The aircraft owner is potentially liable for a wide variety of state and local taxes:
- Sales and use tax
- Income or franchise tax
- Personal property tax
- Registration tax

To make things worse, the implementation of these tax laws varies from state to state. For example, although almost every state has a sales tax, the tax may take the form of a license tax, a gross receipts tax, or a registration tax.

While these kinds of variations may not cause problems for someone who operates in a single state, a business aircraft is, almost by definition, a multistate asset. This means that the owner of a business aircraft is forced to contend with the tax laws of several states:
- The state where the aircraft is purchased.
- The state (or states) where the aircraft is based.
- The states where the owner is a resident or has facilities.
- The states where the aircraft is flown on a regular basis.
- The states where the aircraft is serviced.

Contrary to popular belief, there is no “magic fix”. Putting the aircraft in a Delaware corporation will not avoid tax. An aircraft in interstate commerce is not automatically exempt. Even air carriers are not safe from tax.

Nevertheless, the variation in state laws and the mobility of aircraft makes for interesting planning possibilities. For example, state sales tax on an aircraft purchase can be easily avoided.

On the other hand, making the wrong choice can prove costly. For example, taking delivery of a leased aircraft in some states can cause all future lease payments to be taxed, regardless of where the aircraft is used.

At the moment, there does not seem to be much likelihood that things will get less confusing. Many aircraft owners are content with the status quo, particularly owners located in states where aircraft are favorably treated. The states would have a difficult time working together to achieve uniformity because of variances in tax schemes, many of which are dictated by the state constitutions. Nor do the states appear to have an interest in abdicating their right to tax aircraft to the Federal government. As any state legislator will tell you, taxes are too important a matter to be entrusted to the Federal government.

1.02. State Tax Myths

There are a number of tax myths that have been circulating in the industry (somewhat like the myth that the income tax is a “voluntary” tax):
- A Delaware corporation does not have to pay taxes.
- Aircraft used in interstate commerce are exempt from tax.

Delaware Corporations

Many aircraft owners have been led to believe that putting their aircraft in a Delaware corporation will cause their aircraft to be exempt from all taxes. This is a myth. While Delaware might be considered a “tax haven”, putting an aircraft in a Delaware corporation does not diminish the ability of other states to tax aircraft which are hangared or used in their state. To the contrary, the presence of a Delaware corporation is often a red flag to state tax auditors, since most companies putting their aircraft in a Delaware corporation have paid no tax on their aircraft.

Aircraft Used in Interstate Commerce

Another persistent myth in the aircraft industry is that aircraft are not subject to tax if they are used in interstate commerce. This myth may have a couple of sources. First, in the first half of the century, the decisions of the United States Supreme Court indicated that the Commerce Clause prohibited the states from imposing a direct tax on “instrumentalities of interstate commerce”, such as aircraft. However, subsequent decisions of the Court have not enforced this limitation. Second, in 1969 and in 1983, there were a couple of state supreme court cases which held that the Commerce Clause prohibited the states from taxing aircraft which had entered interstate commerce.
However, this position was uniformly rejected by the other states. In 1987, the latter of the two courts changed their mind, leaving only the dated 1969 case. Since that time, the state courts have uniformly held that aircraft are taxable.

2. General Terms and Concepts

2.01. Basing the Aircraft

The decision where to base the aircraft can have significant state tax consequences. Some states have indicated that they will not tax an aircraft that is hangared in another state. However, the term hangared is generally not defined in the tax laws. One state lists the following “factors to be considered in determining whether an aircraft is hangared in this state”:

- Where the aircraft is rendered for ad valorem [property] taxes;
- Whether the owner owns or leases hangar space in this state;
- Declarations made to the Federal Aviation Administration, an insurer, or another taxing authority concerning the place of storage of the aircraft.

In some situations, there may be ambiguity about where the aircraft is based, such as where the aircraft spends the same amount of time in more than one place. Such ambiguity can create problems, since an aircraft is subject to the greatest risk of taxation in the state where the aircraft is based. In most cases, the best strategy is to reduce the risk by picking the most favorable state and take whatever steps are necessary to insure that the aircraft is considered to be based there.

Registration Requirements

Many states do not have a registration requirement for aircraft. However, if the state does have a registration requirement, failure to register can prove costly.

2.02. Commercial Aircraft

The state tax consequences can vary depending on whether the aircraft is considered a commercial or noncommercial aircraft.

In defining commercial aircraft, many states have adopted the terminology used in the Federal Aviation Regulations:

- Part 91 - noncommercial operations
- Part 135 - charter operations
- Part 121 - airline operations

However, the tax laws do not necessarily follow the FAA definition. Some state taxes define a commercial aircraft by reference to weight. In other cases, the term can apply to aircraft operations that are not treated as commercial operations under the FARs. This means that a flight conducted under FAR Part 91.501, such as a timeshare or interchange, might still be considered commercial for state tax purposes.

2.03. Aircraft Leases

An aircraft lease can take the form of:

- A true lease (a dry lease or an operating lease)
- A sale (a financing lease)
- A transportation service (a wet lease)

These different kinds of leases can have markedly different state tax consequences.

Sale

In some cases, the lease of an aircraft can end up being classified as a sale (or financing lease). In making this determination, most states appear to rely on the same kind of “facts and circumstances” test as is used for Federal income tax purposes. This generally involves consideration of factors such as the term of the lease, the amount financed, and the presence of any bargain purchase options. However, there is at least one state that has adopted the present value tests used by the accounting profession. A few other states have adopted a test based solely on the term of the lease. The use of these alternate tests means that a lease can end up being considered a sale for some purposes of some state taxes and not for others.

Transportation Service

The FARs distinguish between wet leases (plane and pilot) and dry leases (aircraft only). The states make a similar distinction between the lease of an aircraft (an operating lease) and the providing of a transportation service. Both the FAA and the states appear to consider many of the same kinds of factors in making this determination, such as whether the pilots are employees of the lessor and who has control over the conduct of the flight.
2.04. Trade-Ins

Special tax benefits may be available where an aircraft is traded-in for another. For state income tax purposes, the gain on the disposition of the old aircraft can often be deferred. For state sales tax purposes, many states allow a deduction for property taken in trade.

Special attention must be paid to the types of transactions that qualify. An exchange which qualifies as a like-kind exchange for Federal income tax purposes will generally qualify for state income tax purposes, but may not qualify for state sales tax purposes. For example, the state sales tax rules may not allow the kind of multi-party exchanges that are allowed under the Federal income tax rules." Nevertheless, a trade-in that qualifies for state sales tax purposes will probably qualify as a like-kind exchange for income tax purposes.

2.05. Limited Liability Companies

Limited Liability Companies (LLCs) are a new kind of business entity created primarily for Federal income tax purposes. In most cases, an election will be made to treat the LLC as a partnership, which allows deductions to be claimed directly by the partners. Many states now allow the creation of a single-member LLC, which is treated like a sole proprietorship.

The increasing popularity of LLCs has increased the need to consider the manner in which these companies are treated for other purposes. For example, the states are not always consistent in their treatment of LLCs for income tax purposes. There may be differences in the treatment of partnerships and sole proprietorships that make a single-member LLC a better or worse option. For example, a leasing company created for sales tax purposes may not work if incorporated as an LLC. Also, a single-member LLC incorporated in one state may not be treated the same in a state which does not allow single-member LLCs.

One problem in making these determinations is that LLCs are so new that many of these questions have not been considered.

2.06. Constitutional Limitations

The Federal constitution and Federal laws places a number of limitations on the ability of the states to tax aircraft and aircraft operations.

Commerce Clause

The Commerce Clause expressly gives Congress power "[t]o regulate Commerce with foreign Nations, and among the several states". 21

Domestic Commerce

Where a state is attempting to tax an activity which involves only domestic commerce, the Commerce Clause has been interpreted as prohibiting the state from imposing a tax which:

- Applies to an activity lacking a substantial nexus to the taxing state;
- Is not fairly apportioned;
- Discriminates against interstate commerce; or
- Is not fairly related to the services provided by the state. 22

The Supreme Court has struck down schemes that create a significant risk of multiple taxation. On the other hand, the Court has allowed taxes which are either imposed on an apportioned basis or which allow a credit for taxes paid to other states, including:

- Apportioned state income taxes. 23
- Apportioned state property taxes on airline companies. 24
- Unapportioned state use taxes that allow a credit for taxes paid to other states. 25

The Supreme Court has also struck down schemes that tend to impose a higher tax on nonresidents than on residents. For example, an exemption allowed only to carriers that are headquartered in the state is clearly unconstitutional. 26

At one time, there was a belief that the states could not tax aircraft that have been placed in interstate commerce. 27 However, this is no longer true. States have shown no hesitation to tax business aircraft, or even airlines. 28

Foreign Commerce

Where the state is attempting to tax foreign commerce, the Supreme Court has held that, in addition to the above requirements, the tax cannot:
Pose a risk of subjecting foreign commerce to multiple taxation; or
Interfere with the ability of the Federal government to speak with one voice when regulating commercial relations with foreign governments. Applying these tests, an apportioned property tax on containers used in foreign commerce was held unconstitutional. However, a sales tax on the domestic sale of such cargo containers was held not to violate the commerce clause.

The Fourteenth Amendment

The Fourteenth Amendment prohibits any state from "depriving any person of life, liberty, or property, without due process of law" or from denying "to any person within its jurisdiction the equal protection of the laws".

The Due Process Clause

The due process clause has been interpreted as setting limits on the taxing power of the states. As interpreted by the Supreme Court, the due process clause "requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax". As such, this Clause prevents the states from imposing a sales tax on sales taking place outside the state. This Clause also prevents a state from imposing a property tax on an aircraft that has not acquired a "situs" in the state.

The Equal Protection Clause

The equal protection clause prohibits the states from denying "to any person within its jurisdiction the equal protection of the laws". In matters of taxation, this clause generally takes a backseat to the commerce clause.

Supremacy Clause

The supremacy clause prohibits the states from taxing the Federal government. However, this limitation does not prevent the states from imposing a license tax on a person doing business with the Federal government even though the tax is based on a percentage of sales to the Federal government.

2.07. Federal Laws

In addition to the constitution, there are a number of Federal laws that limit the ability of the states to tax certain activities. One example is the Federal law which limits the ability of the states to impose an income tax on any company whose only business activities in that state consist of solicitation of orders for interstate sales. In the case of aircraft, the most important such law is the Anti Head Tax Act.

The Anti Head Tax Act

In 1970, the Federal government assumed primary responsibility for development of airports and airways. As part of this Act, the Federal government imposed a series of taxes, including a fuel tax, a transportation tax and a head tax. In 1973, the Federal government acted to prevent the states from imposing duplicate taxes by enacting the Anti Head Tax Act. This Act essentially prohibits the states from imposing a sales tax, gross receipts tax, or a head tax on air transportation. The major exception to this rule is the provision that allows the imposition of a "passenger facility fee".

Taxation of Overflights

In addition, the Federal law limits the ability of the states to impose other kinds of taxes on overflights. The law allows a state to impose a tax "on or related to a flight of a commercial aircraft or an activity or service on the aircraft only if the aircraft takes off or lands in the state or political subdivision as part of the flight".

Limitations on Property Tax

The Federal law also prohibits the states from taxing air carrier transportation property at a higher value or rate than other property in the same assessment jurisdiction. However, the limitation does not apply to an "in lieu" tax which is completely used for airport and aeronautical purposes.

2.08. Federal Treaties

State taxation is also subject to limitations imposed by treaties between the Federal government and foreign countries. Many treaties contain provisions relating to the taxation of airline operations between the two countries.
3. State Sales and Use Tax

The state sales tax is generally the first tax that should be considered in planning any aircraft acquisition. The aircraft seller has an interest in seeing that the sales taxes are properly collected. The aircraft purchaser has an interest in structuring the transaction to minimize liability for both sales and use taxes.

3.01. General Principles

Over the years, the sales and use tax has become a popular mechanism for raising revenues for local government. As of today, all but a few states have adopted some kind of sales and use tax.

The sales tax has taken a variety of forms:
- Excise tax on sales.
- Business license tax.
- Gross receipts tax.

The use tax is a form of privilege tax and was initially enacted as a “backstop” to the sales tax. Generally, the use tax exempts property upon which the corresponding sales tax has been paid.

Both the sales and use tax have the following elements in common:
- They are both a one-time tax.
- The tax is a percentage of the sales price.
- They utilize the same exemptions and credits.

However, there are also differences between the sales and use tax:
- Only one state is entitled to impose the sales tax.
- The seller is generally liable for collection of the sales tax.

In some states, the general sales and use tax does not apply to aircraft. Instead, the aircraft are subject to a special excise or initial registration tax.

The Sales Tax

There are several different kinds of sales tax. The traditional sales tax is an excise tax on the sale of tangible personal property to the final consumer. Over the years, this tax has been extended to cover other types of transactions, such as repairs to tangible personal property and leases of tangible personal property. In some states, the sales tax has been extended to cover sales of services.

In many states, the sales tax was implemented as a business license tax or as a gross receipts tax. In some cases, this was a matter of necessity, mandated by state constitutional provisions prohibiting an excise tax on sales. In other cases, this was simply a matter of preference.

Distinguishing between these kinds of taxes can often be difficult. However, the consequences can be significant.

Excise Tax on Sales

The most common form of sales tax is an excise tax imposed on the sale of tangible personal property to the final consumer. This kind of sales tax has the following characteristics:
- The tax applies to the sale of property.
- The tax applies only to sales at retail.
- The seller is liable for collecting the tax from the buyer.
- The buyer is also liable for payment of the tax.

The excise tax is subject to the following constitutional limitation:
- The tax cannot be imposed on sales taking place outside the state.

Business License Tax

In some states, the sales tax has taken the form of a business license tax, measured by sales. In contrast with the traditional sales tax:
- Only the seller is liable for the tax.
- The tax can apply to sales for resale, although they are generally taxed at a lower rate.

The business license tax is subject to the following constitutional limitation:
- The seller must be “doing business” in the state.

A state may have both a statewide sales tax and a business license tax measured by sales. Many states with a sales tax also allow the imposition of local business license taxes measured by sales.
Gross Receipts Tax

In some states, the sales tax has taken the form of a gross receipts tax. The language of the law must be reviewed to determine whether the tax is more like an excise tax or a business license tax.

The Use Tax

The use tax is a privilege tax, imposed on the privilege of using the property in the state. The following general principles apply:

▲ The tax is imposed on the use of property in the state.
▲ The tax does not apply where sales tax has been paid.
▲ Credit is allowed for sales or use tax paid to other states.
▲ Sellers are asked to collect tax on deliveries into the state.
▲ The buyer is always liable for the tax.

The use tax is subject to the following constitutional limitations:

▲ The use tax cannot discriminate against out of state buyers.
▲ Credit must be allowed for sales and use taxes paid to other states.
▲ A seller cannot be required to collect tax on deliveries into the state unless the seller is doing business in the state.

The Initial Registration Tax

A few states impose an initial registration tax on aircraft, which essentially takes the place of both the sales and the use tax. Registration is typically required only for aircraft that are going to be based in the state. Although the initial registration taxes often do not have a resale exemption, they typically do not apply to aircraft held by dealers. In the case of a lease, special rules determine whether the lessor or the lessee is required to register the aircraft.

The initial registration taxes have the following characteristics:

▲ The tax is a one-time tax.
▲ The tax can be imposed at time of sale or time of registration.
▲ The tax typically applies only to aircraft based in the state.
▲ Dealers are generally exempt.
▲ The user is liable for the tax.

There are also a few states which, in the case of aircraft, treat their sales or use tax like an Initial registration tax. These states tend to require payment of sales or use tax only if the aircraft is to be based in the state.

3.02. Computation of the Tax

Regardless of the nature of the tax, the method of computation is generally the same. The tax is generally computed as a percentage of the sales price. The same exemptions are generally allowed for both sales and use tax purposes. In many states, a reduction is allowed for trade-ins. The tax rates are generally the same.

Differences in the computation of the use tax are allowed, as long as the difference does not discriminate against property purchased outside of the state. For example, the use tax may be computed using the depreciated value of the property. The use tax laws may allow additional exemptions for property previously used outside of the state. And there may be no county use tax.

Common Exemptions

Fly-Away Exemption

Many states do not impose sales tax where an aircraft is sold within the state to a nonresident who is immediately taking the aircraft out of the state. The requirements of these exemptions vary from state to state. Some require that the aircraft be removed from the state "immediately" while others specify a period of time, such as 10 days. The requirement that the purchaser be a nonresident may pose problems for a company that is doing business in the state, even where the headquarters are in another state. This exemption applies only for sales tax purposes and not for use tax purposes.

Resale Exemption

Essentially every state allows an exemption for aircraft sold for resale or lease. The major exception is in those states where the sales tax takes the form of a business license tax. In many of those states, a sale for resale is not exempt, but is taxed at a lower rate.
few states do not exempt a sale for lease or a lease for sublease. The laws or regulations of a few states indicate that sales to out-of-state dealers or lessors are not exempt. Fortunately, the Courts have not always enforced this requirement. A few states limit the exemption to sales for resale in the United States.

Common Carrier Exemption

Most states have some kind of common carrier exemption. But the types of activities covered differ from state to state. Some exempt only airlines, while others also exempt charter operations or simply operations which cross state lines.

Occasional Sales Exemption

While most states have an occasional sales exemption, the exemption typically does not apply to aircraft. Nevertheless, there are some states that, as a matter of policy, do not tax sales of aircraft that are not going to be based in the state. This is particularly true in those states where the sales tax on aircraft is considered to be an initial registration tax. In many states, the occasional sales exemption is valid only for sales tax purposes. In other states, the exemption applies for both sales and use tax.

The Reduction for Trade-Ins

Where used property is traded-in on new property, many states provide that tax is charged only on the difference. This rule can apply not only to aircraft, but also to aircraft parts. For example, many aircraft owners purchase remanufactured parts, and obtain credit for turning in their old cores. Many states allow a reduction for the allowance given on the old core, including some states that do not ordinarily allow a deduction for trade-ins.

3.03. Sales Tax Concerns of Seller

In the case of aircraft, the sales tax is easily avoided by selecting the state in which the sale takes place. However, once a state is selected, careful attention must be paid to following the rules. Otherwise, there is a risk that the seller will end up having to pay the tax. Regardless of whether the sales tax is structured as an excise tax or a business license tax, the seller is made liable for the tax. Generally, the only way the seller can avoid liability for the sales tax is for the seller to obtain a valid exemption certificate.

Valid Exemption Certificate

In order to be valid, the exemption certificate generally must be:
- Signed and dated by the purchaser.
- Must state a valid exemption.
- Must be accepted in good faith.

Some states have preprinted exemption certificates that can be used. However, these are not available in every state. In other cases, the states have been known to use the exemption certificates to add provisions that are not required by the law. In these cases, the seller must draft an exemption certificate and hope that it is accepted on audit. Regardless of what happens, the seller is better off having an imperfect exemption certificate than having none at all.

Valid Exemption

The Seller should ensure that the exemption claimed by the Purchaser is valid for that state. The Seller is presumed to have knowledge of the law. The Seller may have to make a judgement call where the exemption is based on a Court interpretation, particularly where the state tax Authorities do not agree with this interpretation.

Good Faith

The Seller must accept the certificate in good faith. This means that, where the purchaser says that the aircraft is going to be used for a specific purpose, the seller does not have a duty to investigate. However, this is not the same as “blind faith”. The good faith defense would be cast in serious jeopardy if:
- The aircraft could not possibly be used for the purpose stated.
- The purchaser has engaged in overt conduct that makes the lie apparent.

Where the seller is a company, the person accepting the certificate is assumed to be aware of all facts which are known to other employees of the company.

Passing on Liability for the Tax

Where a sales tax takes the form of a business license tax, the only person liable for the tax is the seller. In order to make the purchaser liable for the tax, the sales contract should provide that the purchaser will reimburse the seller for this tax.
The Statute of Limitations

One of the risks of not collecting sales tax is that, if the seller is eventually forced to pay the tax to the state, the seller will not be able to obtain reimbursement from the purchaser because the statute of limitations has run.

Aviation Mythology

There are a couple of aviation sales tax myths that should be mentioned:
- Isolated sales of aircraft are exempt under the casual sales exemption.
- A “hold harmless” agreement relieves the seller from liability for sales tax.

Isolated Sales of Aircraft

Although most states have a casual sales exemption, most are specifically not applicable to aircraft.

Hold Harmless Agreements

Some sellers are under the impression that liability for sales tax can be avoided if the purchaser provides the seller with a hold harmless agreement. While such agreements may be binding between the parties, they have no effect on the state tax authorities.

3.04. Sales Tax Concerns of Purchaser

The purchaser of an aircraft will generally want to avoid having to pay the sales tax. Since an aircraft is a mobile asset, it is possible to avoid the sales tax by careful selection of the state in which the sale takes place. This kind of tax avoidance is perfectly legal. The problems arise where the participants do not comply with the legal requirements, or worse, where they try to cover-up a failure to comply with those requirements.

How to Avoid the State Sales Tax

In order to avoid state sales tax on an aircraft sale, the following steps should be taken:

1. Identify a state where tax can be avoided:
   - No sales tax.
   - An appropriate exemption (e.g. the “fly-away” exemption).

2. Make sure that the sale takes place in that state:
   - The paperwork must be unambiguous, particu-

larly the delivery receipt.
   - The aircraft must be in the state at the time the sale occurs.

3. Insure that the appropriate exemption certificates are completed:
   - The exemption claimed must be appropriate for the state.
   - The exemption certificate must be accepted in “good faith”

3.05. Use Tax Concerns of Seller

Where a seller ships property into a state, the seller may be required to collect use tax from the purchaser. The supreme court has held that a seller cannot be required to collect use tax where the seller does not have people or property in that state.

Aircraft Sales

Some ingenious state tax authorities have attempted to convince sellers that they have an obligation to collect use tax on out-of-state sales of aircraft, particularly where the seller knows that the aircraft will be based in the state and the seller has facilities in the state. However, under the Federal constitution, the states do not have the authority to impose this obligation since each sale is considered in isolation.

3.06. Use Tax Concerns of Purchaser

The same mobility that makes the sales tax so easy to avoid, makes the use tax more difficult to avoid. An aircraft can be subject to use tax in several states. Even if an aircraft is exempt in one state, it could be taxable in another.

Activities Subject to Tax

The states have taken a very liberal view of the amount and kind of usage that is subject to use tax. There are cases where an aircraft was subjected to use tax where the aircraft was based outside of the state and used only 17% of the time in the state. In one extreme example, an aircraft was subjected to use tax where the only activity was the making of a maintenance flight.

Additional Use Tax Exemptions

In addition to the normal sales tax exemptions, the following exemptions may apply for use tax purposes:
Temporary Use

Many states, either as a matter of law or policy, do not impose use tax on aircraft which are only located temporarily in the state. This particularly makes sense where the aircraft is not actually being used in the state, as in the case of an aircraft that is being repaired.

Aircraft Based Outside of the State

Some states have indicated that they will not impose use tax on aircraft that are based outside of the state. However, this may not apply where the user is a resident of the state.

Purchase for Use Requirement

Since the use tax was originally enacted as a backstop to the sales tax, many states have incorporated the requirement that the property have been purchased for use in the state. Some states implement this requirement by creating a presumption that property used outside of the state for a certain period of time (e.g., 90 days) was not purchased for use in the state. However, this presumption can be defeated by a showing that the property was clearly intended to be used in the state, e.g. where the aircraft is to be used by a company which is headquartered in the state.

Prior use in Another State

In the absence of a “purchase for use” requirement, prior use in another state will generally not exempt property from use tax, particularly in the case of business property. However, there are exceptions.

Developing a Strategy

Fortunately, developing a strategy to evaluate the use tax exposure does not require an analysis of the laws of all fifty states. Instead, the planning efforts should be focused on the following states:

▲ The states where the aircraft will be used more than 10% of the time.
▲ The states where the aircraft might be based.

In analyzing the use tax laws, the following factors should be considered:

▲ Whether the state has a use tax.
▲ Whether aircraft are exempt.
▲ Whether the state has a reduced tax on aircraft.
▲ Whether the state has a useful exemption for commercial aircraft.
▲ Whether a private leasing company can be used to avoid or defer taxes.

Once the laws have been reviewed, the decision can be made where to base the aircraft. This decision should take into account factors other than just the use tax. After all, the primary reason for purchasing an aircraft is for convenience. To take an extreme example, it makes no sense for a New York corporation to base their aircraft in Oregon in order to avoid the use tax. In many cases, there is only one practical place to base the aircraft. If that case, the tax planning must adapt to the laws of that state. In other cases, there may be a choice of locations.

Once the decision where to base the aircraft is made, steps should be taken to insure that there is no ambiguity:

▲ The aircraft should be registered in that state.
▲ The appropriate property or registration taxes should be paid.
▲ The aircraft should be hangared in that state.
▲ The aircraft should be insured in that state.

The worst thing that can be done is to create ambiguity about where the aircraft is based, since that gives several different states an argument for imposing the use tax.

3.07. Using a Leasing Company to Defer or Avoid Taxes

One commonly used technique to defer payment of sales and use tax is to create a leasing company. In most states, this allows for a tax deferral since the sale of the aircraft to the leasing company is exempt from sales tax as a sale for lease. Instead, sales tax is charged on the lease payments.

In certain situations, a leasing company can also be used to avoid payment of sales or use tax. For example, in many cases, a customer will purchase an aircraft with the expectation that the aircraft can be leased to a Part 135 operator. Even assuming that the lease payments made by the Part 135 operator are exempt from sales tax, the customer will have paid use tax on the entire aircraft, even though the customer is not using the entire aircraft. By creating a leasing company that leases to both the customer and
the Part 135 operator, tax will be charged only on the lease payments made by the customer. For example, if the aircraft is leased to a Part 135 operator 50% of the time, then the customer will effectively pay sales tax on only 50% of the aircraft.

Of course, there are situations where a leasing company is not a viable alternative. Some states do not allow for special treatment of leasing companies. Where the aircraft is acquired as part of a trade-in and the sales tax law allows for deduction of trade-ins, the amount of sales tax deferred might be much less.

3.08. Other Sales and Use Tax Issues

Taxation of Repairs and Overhauls

Many states charge sales tax on the labor portion of repairs and overhauls. Aircraft owners might prefer not to have to pay the sales tax, particularly where the aircraft is based in a state which does not tax this labor, or does so at a much lower rate.

There are a couple of ways to avoid the tax.

▲ A leasing company can often be used to avoid tax on such repairs since, where the lessor is obligated to make the repairs, they are generally exempt under the resale exemption. The downside is that the overall lease payments must be increased to cover the cost of assuming this obligation.

▲ Particularly in the case of major repairs and overhauls, the customer might try to convince the repair company to hold off passing “title” to the parts and labor until the aircraft reaches the state where the aircraft is based. This would cause the transaction to be subject to sales tax in the state where the sale takes place, rather than the state where the services are performed.

Maintenance Agreements and Extended Warranties

The proliferation of maintenance agreements and extended warranties has created a great deal of confusion among the states. About half of the states take the position that the payments are subject to tax, while the other half take the position that no tax is due until the repairs are performed. Even worse, there is one state that has taken the position that the payments under an engine power program are subject to tax, even where the engine repairs would be exempt from tax.

Under these circumstances, there may be an incentive to avoid having to pay sales tax on the payments. The trick is to insure that the “sale” of the agreement takes place in a state that does not tax such payments. One problem is that, since there is no item of tangible property that changes hands, it may be difficult to determine the place of sale. Some steps which might be considered are signing the contract in, and arranging for payments to be sent to, a state which does not tax such payments.

4. State Property/Registration Tax

The property tax can be just as significant as the sales tax. Many of the states with a low sales tax make up for lost revenues with a high property tax. And, unlike the sales and use tax, the property tax is paid every year. Since the average tax rate is around 2-3% of fair market value, this tax can add up quickly.

Many states impose an annual tax on personal property. In the case of aircraft, many states impose an annual registration tax, which is in lieu of the property tax.

4.01. Property Tax

The property tax is generally computed based on the value of the property, which is why the tax is also often referred to as an “ad valorem” tax.

Computation of the Property Tax

The computation of the property tax generally involves consideration of the following factors:

▲ The types of exemptions which are available

▲ The allowable methods of computing the taxable value

▲ The tax rate which applies

In the case of business aircraft that are used in several states, consideration must also be given to the possible impact of the apportionment rules.

Exemptions

Aircraft are considered personal property. Some states do not tax personal property. In some states,
nonbusiness aircraft have been held to be exempt as personal assets. In at least one state, business aircraft are exempt from tax.

**Taxable Value**

The computation of the taxable value generally involves the following steps:
- **Determination of fair market value**
- **Determination of assessed value**

Some states require that all property be valued “uniform and equally” using the same rules for all property. Other states have adopted classification rules, which allow different kinds of property to be valued differently.

**Fair Market Value**

The method of computing fair market value can vary considerably. Some states consider only fair market value. Other states allow the use of a depreciated cost, and sometimes allow the use of accelerated depreciation. Other states use trending tables, which take into account both depreciation and inflation.

**Assessed Value**

The tax computation is made by reference to the assessed value, which is generally a percentage of fair market value. In some states, the same percentage is used for all property. Other states allow the use of different percentages for different kinds of property.

**Tax Rate**

The tax rate is computed by the taxing authorities and generally changes from year to year. In most cases, the same rate applies to all property. In some cases, different rates apply to different kinds of property.

**The Apportionment Rules**

Where an aircraft is used in several states, consideration must be given to the possible application of the apportionment rules. These rules can either allow a reduction of the tax in the state where the aircraft is based, or cause an aircraft to be taxed in a state outside where the aircraft is based. The apportionment rules are the result of the following factors:
- **The common law rule.**
- **The due process clause.**
- **The commerce clause.**

**The Common Law Rule**

Under the old common law doctrine, personal property was taxable entirely in the domicile of the owner. A corollary of this rule was the “home port” doctrine, which held that ships could be taxed only in their home port. In the first case addressing the taxation of aircraft, the Supreme Court held that aircraft were taxable entirely in the state of domicile. However, in a subsequent case, the Supreme Court held that aircraft could be taxed outside of the state of domicile. Furthermore, the Supreme Court appears to have rejected the home port doctrine. Nevertheless, the Court has held that the domicile state retains the power to tax property that is not taxable elsewhere.

**The Due Process Clause**

The Supreme Court held a nondomiciliary state could impose a property tax on the aircraft, where the aircraft had a situs in that state. Conversely, the due process clause prohibits the domiciliary state from imposing tax where the property does not have a situs in that state.

**The Commerce Clause**

Once property has acquired a situs in a state, the commerce clause requires that the tax be apportioned. Similarly, where property has acquired a situs in a nondomiciliary state, the domicile state is required to apportion the tax. Apportionment has also been required in the case of property used in foreign commerce.

**Taxation of Commercial Aircraft**

Because of these constitutional constraints, almost every state has adopted special provisions relating to commercial aircraft:
- **The aircraft are assessed at the state level, rather than the local level.**
- **The tax is apportioned.**
- **There is no need to prove an out-of-state situs.**

**Aircraft Covered**

These provisions generally apply only to interstate airlines. However, in some cases, these provisions apply to other kinds of aircraft. For example, in some states, the exemption is based on the weight of the
aircraft. And some local tax assessors have allowed other types of aircraft to compute tax on an apportioned basis, without the need to prove an out-of-state situs.

Federal Limitations

In the case of commercial aircraft, Federal law prohibits the states from taxing air carrier transportation property at a higher value or rate than other property in the same assessment jurisdiction. However, the limitation does not apply to an “in lieu” tax which is completely used for airport and aeronautical purposes.

Taxation of Other Aircraft

The taxation of other aircraft is not necessarily subject to rules that are as clear. For example, the final outcome could be the result of a series of negotiations. For example, the state of domicile might assert a right to tax the entire aircraft, unless the owner could show that the aircraft has acquired a situs in another state. If the aircraft is based outside the state of domicile, then the owner should have little difficulty meeting this burden. However, in that case, the state in which the aircraft is based might assert a right to tax the entire aircraft.

In the case of noncommercial aircraft, most tax authorities appear to be inclined to accept the proposition that such aircraft should be taxed only in the state where the aircraft is based. This may be a matter of economics. Although the tax authorities could attempt to increase tax revenues by taxing aircraft based outside of the state, any revenue gains could easily be offset by tax revenues lost to owners of aircraft based in the state. Faced with this kind of “zero sum” game, the tax authorities have a clear incentive to avoid the costs of litigation by accepting a clear answer, instead of the “right” answer.

Tax Tricks

The state tax Laws generally provide for the taxation of property located in the state on a certain day of the year. Some aircraft owners have viewed this as an opportunity to avoid tax-by insuring that the aircraft is not in the state on that date. However, the Courts have held that the fact that the aircraft is not present on assessment date does not necessarily allow the aircraft to escape tax.

4.02. Annual Registration Tax

Many states impose an annual aircraft registration tax, which is in lieu of the property tax. In many cases the registration tax is lower than the general rate of tax. In those states, failure to register the aircraft can mean that the taxpayer is not entitled to take advantage of the lower rates.

5. State Income Tax

State income taxes generally take a backseat to Federal income tax planning. This is because state income taxes are generally computed by reference to Federal taxable income and the state tax rates are much lower than the Federal tax rates. Nevertheless, the decision where to base the aircraft and the manner in which the aircraft is used can have a significant impact on the owner’s state income tax liability.

5.01. Duty to File State Income Tax Returns

Basing an aircraft in a state will generally trigger an obligation to file returns and pay state income tax. Except in the case of airlines, merely flying into a state, even on a regular basis will probably not trigger this obligation. And, even in the case of airlines, this obligation will not be triggered where the aircraft merely flies over the state.

Since aircraft are generally based near existing facilities, these rules should not create problems, unless the aircraft is placed in a separate corporation or is based in a state where the company does not already have operations.

One question that has not been fully resolved is whether a lessor has an obligation to file returns and pay state income tax where the lessee uses the property in the state. Several states have taken the position that the lessor is obligated to file returns and pay the tax. However, there is some case law that indicates otherwise.

5.02. Change to Apportionment Factors

The presence of an aircraft can change the company apportionment factors.
Essentially all of the states use some kind of apportionment formula in order to compute the income taxable by the state. The traditional formula is the arithmetic average of the following three factors:

- the ratio of sales in the state to total sales
- the ratio of property in the state to total property
- the ratio of payroll in the state to total payroll

The property factor might be computed using either historical cost or net book value. Leased property is generally added to the property factor by using a multiplier, e.g. four times the lease payments.

The presence of an aircraft can directly affect both the property and the payroll factors. Where the taxpayer is engaged in air transportation, the taxpayer can be required to use a completely different allocation formula. For example, in some states, a common carrier is required to use an allocation formula based on factors such as revenue miles, revenue tons, or overflight miles.

A leased aircraft will generally have less impact on the property factor since the multipliers used to convert lease payments to property values generally underestimate the value of the aircraft, particularly in the early years of the lease.

5.03. The Consolidated Return Trap

Many states do not allow the filing of consolidated or combined returns. This can create a trap where the aircraft is purchased by a member of a consolidated group that does not have sufficient income to offset against the aircraft deductions.

6. Other State Taxes

Fuel and insurance are two of the major expenses associated with aircraft operations. Special taxes may apply to these expenses.

6.01. State Taxes on Fuel

Every state appears to have some kind of tax on fuel. Many states have a separate tax on fuel. In other states, fuel is taxable under the general sales and use tax laws.

The laws may impose different rates of tax on avgas and jet fuel.

The Supreme Court has held that the commerce clause does not prohibit the imposition of an unapportioned sales tax on aviation fuel, even where the fuel will be primarily consumed outside of the state. The Court has also held that such tax is not prohibited by Federal legislation, in particular, the Anti-Head Tax Act. Nevertheless, some states do not tax the portion of fuel used outside of the state.

Although there is not much that can be done to avoid this tax, the fuel tax can be an important factor in deciding where to base an aircraft.

6.02. State Taxes on Insurance

Insurance is one of the major costs of aircraft ownership. Where an aircraft is insured by a company that is not admitted in the state (e.g. Lloyds of London), many states charge a “surplus lines” tax. However, the tax is not necessarily due on the entire premium. The tax applies only to the insurance of risks in the state. To the extent that the aircraft is located outside of the state, an argument can be made that the tax should not apply. This is particularly true where the insurance is for the risks associated with travelling outside of the United States, such as war risk insurance.

6.03. State Taxes on Transportation

The Federal Anti-Head Tax Act prohibits the states from imposing taxes on interstate transportation. However, the Act does not prohibit the states from imposing transportation taxes on intrastate transportation, such as sightseeing trips. A few states have enacted taxes on such transportation.

7. Recent Trends and Developments

7.01. State Sales and Use Tax

Several states have amended their laws to exemption aircraft repairs and overhauls from sales tax. The motivation for this legislation appears to be to encourage aircraft repair shops to locate in the state.

However, this exemption can lead to some odd results:

- Since repairs are exempt, while the aircraft are not, an aircraft buyer can save taxes by purchasing an aircraft that is in need of refurbishment for a low price, and having the aircraft refurbished tax-free.

14 State Taxes on Aviation
The states which exempt only repairs made to nonresident aircraft are discriminating against residents, who must pay tax.

7.02. State Property/Registration Tax

In recent years, some states have started to allow the use of allocation for business aircraft. Under this approach, aircraft are taxed only to the extent that they are used in the state.

7.03. State Income Tax

Traditionally, the states have allocated income using a three-factor formula that gives equal weighting to sales, property and payroll. Some states used variations, such as a single factor, based on sales.

In recent years, there has been a marked trend towards a double weighting of the sales factor. The obvious reason for this trend is that it gives an advantage to companies which are located in the state and which make sales to other states.

The effect on aircraft owners is that this lessens the weighting that will be given to the property and payroll factors, which are typically affected by the purchase of an aircraft. In fact, to the extent that an aircraft generates additional out-of-state sales, the purchase of an aircraft can actually reduce state income taxes.

End Notes

1 See e.g., Federal Express Corp., 693 N.E.2d 682 (Mass. 1998).


3 There may be non-tax reasons for incorporating in Delaware, such as a preference for the rules applicable to shareholders and directors, or the bankruptcy laws.


7 Superior Aircraft Leasing, Inc., 734 S.W.2d 504 (Mo.1987).


9 See, e.g., Xerox Corp., 71 A.D.2d 177 [“use tax may only be imposed upon an aircraft at the location at which the aircraft is hangared”]; Tex. Reg. 3.297.

10 Tex. Reg. 3.297.

11 In addition to the normal sanctions and penalties, failure to register can prevent the owner from utilizing tax advantages available to registered aircraft. See, e.g., First Security Bank of Idaho, N.A., 735 P.2d 1044 (Idaho App. 1986) [failure to register prevented taxpayer from using lower property tax rates applicable to aircraft]; Cincinnati Air Taxi, Inc., 180 N.E.2d 17 (Ohio 1962) [same]; Czars, Inc., Mich. Tax Tribunal, Dkt. No. 220832 (10-1-96) [failure to register as lessor prevented taxpayer from obtaining deferral of sales tax].

12 See, e.g., Fla. Law 212.08(7)(rr) [sales tax- “As used in this paragraph, ‘common carrier’ means an airline operating under Federal Aviation Administration regulations contained in Title 14, chapter I, part 121 or part 129 of the Code of Federal Regulations.”]

13 See, e.g., Ark. Law 25-52-301(c)(vi) [sales tax- “The term ‘commercial jet aircraft’ shall mean any commercial, military, private or other turbine or turbo jet aircraft having a certified maximum take-off weight of more than 12,500 pounds.”]; Mo. Law 155.010 [property tax- “‘Commercial aircraft’, aircraft fully equipped for flight and of more than ten thousand pounds maximum certified gross take-off weight.”]
16. **State Taxes on Aviation**

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14. See, e.g., Florida Growers Coop. Transport v. Department of Revenue, 273 So.2d 142 (Fla. App.) [sales tax exemption applied to Coop, which was exemption from certification under the FARs].

15. The factors considered by the IRS are listed in Rev. Rul. 55-540.


18. See, e.g., Air Methods, Inc., Minn. Tax Ct., No. 5127 (9/19/1989). However, the author has been advised that Iowa treats all aircraft leases as transportation services, including dry leases.

19. See, e.g., Ind. Law 6-2.5-1-6(c)(1).

20. For example, Florida initially considered LLCs to be taxable as corporations.


32. U.S. Constitution, 14th Amendment, Clause 1.


36. U.S. Constitution, 14th Amendment, Clause 1.


40. In that year Congress enacted the Airport and Airway Development Act and the Airport and Airway Revenue Act, P.L. 91-258.

41. P.L. 93-44.

42. 49 USC 40116(b), as added by P.L. 93-44 (1973) and amended by P.L. 97-248 (1982), states that:

   . . . a state, (and) a political subdivision of a state . . . may not levy or collect a tax, fee, head charge, or other charge on -

   (1) an individual traveling in air commerce;

   (2) the transportation of an individual traveling in air commerce;

   (3) the sale of air transportation; or

   (4) the gross receipts from that air commerce or transportation

43. 49 USC 40117 authorizes the Secretary of Transportation to allow an airport agency to charge a fee of up to $3 per paying customer in order to
finance an eligible airport-related project.

44 49 USC 40116(c).
45 49 USC 40116(d).
46 49 USC 40116(d).
47 The only states which have not adopted some kind of sales and use tax are: Montana, New Hampshire, and Oregon. Contrary to popular belief, both Alaska and Delaware have a sales tax. Alaska has local sales taxes and Delaware has a statewide business license tax.
48 See, e.g., Illinois.
50 See, e.g., Southwest Kenworth, Inc., 561 P.2d 757 (Ariz. App. 1977) ["It has been firmly established that this tax is not one levied on the sale itself but on the privilege of engaging in business in Arizona, measured by the gross receipts from sales."].
52 See, e.g., Delaware and Hawaii.
54 Washington has both a statewide gross receipts tax (the Business and Occupation, or B&O, Tax) and a sales tax.
55 See, e.g., Virginia.
56 Compare the Arkansas Gross Receipts Tax Law 26-52-301 ["There is levied an excise tax . . . upon the gross proceeds or gross receipts derived from all sales to any person of the following . . ."] with the New Mexico Gross Receipts Tax Law 7-9-4 ["For the privilege of engaging in business, an excise tax equal to five percent of gross receipts is imposed on any person engaging in business in New Mexico."].
60 See, e.g., Minnesota and, effective 1999, Iowa.
61 Haliburton Oil Well Cementing v. Reily, 373 U.S. 64 (1963) [exceptions]; Associated Industries of Missouri v., 511 U.S. 641 (1993) [county use tax].
62 See, e.g., N.Y. Law 1111(b)(1) [if the property was first used outside of New York for more than 6 months, the tax will be computed based on the lower of cost or the value of the property when first used in New York]; Penn. Law 201(g)(5).
63 See, e.g., Delaware and Hawaii.
64 See, e.g., Illinois and Maine.
65 See, e.g., New York.
66 See, e.g., Tex. Law 151.006(2).
69 See, e.g., Anchor Boats, Inc., Dkt.No.16991 (Wash. BTA 1978) [sale of boat taxed where seller failed to obtain certification that boat was sold to nonresident for use outside state, even though it was obvious that boat qualified].
70 Leisure Dynamics, Inc., 298 N.W.2d 33 (Minn. 1980).
72 See, e.g., Montgomery Ward & Co., 272 CA2d 728 (Calif. App. 1969) [Nevada and Oregon stores not required to collect California use tax on over-the-counter sales to California residents.]
73 Superior Aircraft Leasing, 734 S.W.2d 504 (Mo. 1987); Frank W. Whitcomb Construction Corp., 479 A.2d 164 (Vt. 1984).
See, e.g., Kans. Law 79-3704(a) [exempts use for 60 days or less by nonresident].

See, e.g., Xerox Corp., 71 AD 2d 177 [“use tax may only be imposed upon an aircraft at the location at which the aircraft is hangared”]; TX Reg. 3.297.


See, e.g., Calif. Law 6248.

See, e.g., Calif. Law 6248 [90 days].

American Airlines, Inc., 216 Cal App 2d 180 (1963) [parts stored and tested outside of California for as long as 292 days before being shipped for installation on aircraft in California].


The following states do not have a use tax: Delaware (except for a use tax on leases), Montana, New Hampshire, Oregon.

Both Connecticut and Oklahoma have aircraft exemptions.

See, e.g., North Carolina and South Carolina.

See, e.g., Maryland and New York.

There are other ways to achieve the same result, such as having the Customer and the Part 135 Operator become joint owners of the aircraft. However, a lease is generally a simpler alternative.


Fla. Technical Assistance Advisement 97(A)-051.

See, e.g., New Hampshire and North Carolina.

App. 1986); Bi Go Markets, Inc., and Wettersau, Inc., 843 S.W.2d 916 (Mo. 1982).


111 If an aircraft flies into a state on a regular basis, there are probably other things, such as employees or facilities which have already triggered this obligation.

112 49 USC 40116(c). See, e.g., Delta Air Lines, Virginia Cir Ct. Arlington County, No. 93-1238 (1/27/98).

113 See, e.g., Fla. Rule 12C-1.011(2) [“leasing aircraft to commercial airlines that routinely fly air-
craft into Florida will subject the leasing company to the tax”].

114 See, e.g., Ryder Truck Rental, Inc., 520 So.2d 1333 (Miss. 1987) [a sales tax case which cited several income tax cases].

115 See, e.g., Fla. Rule 12C-1.0151(2)(c). But see Delta Air Lines, Virginia Cir Ct. Arlington County, No. 93-1238 (1/27/98), which says that overflight miles cannot even be considered.


118 49 USC 40116(b).