2014 AVIATION STATE TAX UPDATE

Colorado

New Exemption for Aircraft Charter Operators

On or after July 1, 2014, but prior to July 1, 2019, the sale of a new or used aircraft shall be exempt from state sales and use tax if: (i) the aircraft is purchased for use by an on-demand air carrier (i.e., charter operator), regardless of whether the purchaser is a resident of Colorado; (ii) the aircraft will remain in the state only for the purpose of final assembly, maintenance, modification or completion; (iii) the aircraft will be removed from the state within 120 days after the date of the sale; and (iv) the aircraft will not be in Colorado more than 73 days in any of the three calendar years following the calendar year in which the aircraft is removed from Colorado. An aircraft that is hangared or parked overnight shall be considered to be in the state for purposes of this exemption. COLO. REV. STAT. § 39-26-711.8.

Georgia

Exemption for Aircraft Repair Parts and Components Made Permanent

Effective July 1, 2014, Georgia's sales and use tax exemption for the sale or use of engines, parts, equipment and other tangible personal property used in the maintenance or repair of aircraft when such engines, parts, equipment and other tangible personal property are installed on such aircraft being repaired or maintained in this state, so long as such aircraft is not registered in this state, is made permanent. GA. CODE ANN. § 48-8-3(86). The above exemption was previously scheduled to sunset on June 30, 2015.

Illinois

New Test in Illinois for Aircraft "Rolling Stock"

An aircraft acquired on or after January 1, 2014 must be operated as rolling stock in interstate commerce for hire for more than 50 percent of the aircraft's total trips or miles during any 12-month period of ownership in order to be exempt from Illinois sales or use tax.

Beginning this year, a person claiming the rolling stock exemption for a newly acquired aircraft must elect to use either a "trips" or a "mileage" methodology for purposes of determining whether more than 50 percent of the aircraft use is in interstate commerce for hire. Under the trips test, for any 12-month period, more than 50 percent of the aircraft's total trips must be made in interstate commerce for hire. The new law does not define what constitutes a "trip" for aircraft. However, with respect to motor vehicles used as rolling stock, the Illinois Department of Revenue has defined a "trip" to mean "movement from one location to another" (ILL. ADMIN. CODE tit. 86, § 130.340(h)(1)(c) (2008)). This definition may also apply to aircraft.

Under the mileage test, for any 12-month period, more than 50 percent of the aircraft's total miles must be accumulated in interstate commerce for hire. The legislation provides that an aircraft owner may substitute flight hours in lieu of mileage.

The aircraft owner makes the trips or mileage election at the time of purchase and documents the election in its books and records. Once the election is made, it remains in effect for the duration of ownership of the aircraft. If no election is made, the mileage test (which presumably includes flight hours) is used.

This new law also applies to aircraft components. Accordingly, an aircraft component acquired on or after January 1, 2014 to be affixed to an aircraft will not be exempt from Illinois sales or use tax unless the aircraft to which such component is affixed has a total of greater than 50 percent of its use in interstate commerce for hire (i.e., as rolling stock), regardless of when the aircraft was purchased. Accordingly, to claim a rolling stock exemption for aircraft components purchased on or after January 1, 2014, owners of aircraft acquired prior to that date must also comply with the greater-than-50-percent threshold and make an election in their books and records to use either the trips method or the mileage method.

Fractional Ownership of Aircraft

In IPC Aviation, Inc. v. Ill. Dep't of Rev., No. 2008-L-050974 (Feb. 19, 2014), a circuit court judge held, on an issue of first impression in Illinois, that: (1) a fractional ownership interest in an aircraft is tangible personal property subject to Illinois use tax, and (2) that the aircraft was put into "use," subjecting it to Illinois use tax, because the aircraft had physically entered the state on multiple occasions and because the owner, through its ownership rights in the aircraft, had caused other aircraft within the fractional fleet to enter the state for use in the owner's business. The aircraft owner contended, among other points, that the aircraft did not have sufficient nexus to be subject to Illinois use tax under the Commerce Clause of the U.S. Constitution because less than 8 percent (56 of 713 flights) of the aircraft's flights were to or from Illinois and because the aircraft owner itself had only used its actual aircraft on five occasions with only three of those flights having originated or departed from Illinois. The circuit court judge determined that substantial nexus existed, not by how often the aircraft owner used its actual aircraft in Illinois, but by how often the owner exercised its ownership interest in its aircraft to summon substitute aircraft for its use under the fractional program, which, according to the judge, constituted an additional 116 uses for purpose of Illinois use tax.

Michigan

What Constitutes "Use"

In NACG Leasing v. Dep't of Treasury, No. 146234 (Feb. 6, 2014), the Michigan Supreme Court held that an owner and lessor of an aircraft, which was acquired and immediately net leased to a company already in possession of the aircraft, owed Michigan use tax on the aircraft. Reversing the appellate court, the supreme court held that the owner (lessor) had used the aircraft in Michigan by entering into the lease agreement with the lessee in Michigan, which act was an exercise of the owner's right or power over the aircraft sufficient to subject the owner to Michigan use tax. Specifically, the supreme court held that because the right to allow others to use one's personal property is a right incident to ownership, and a lease is an instrument by which an owner exercises that right, it follows that the execution of a lease is a taxable use, regardless of actual possession of the aircraft by the owner (lessor). The Michigan Supreme Court distinguished two prior Michigan appellate court decisions, which provided for the general proposition that an aircraft owner and lessor may not be subject to Michigan use tax, if the owner

(lessor) can show that it relinquished total control and uninterrupted possession of its aircraft to the lessee, by noting that the referenced cases did not involve a lease executed in Michigan.

Aircraft Acquired for Lease Not a Sale for Resale

In FMG Leasing, LLC v. Dep't of Treasury, No. 312448 (June 26, 2014), the court held that an aircraft acquired for lease to related parties on very favorable terms was not acquired for resale and therefore the owner (lessor) could not claim a resale exemption on the aircraft's purchase price and collect sales tax on the lease payments. The court in support of its decision noted that the aircraft's lease payments could not generate a profit for its owner and that the owner never marketed the aircraft to third parties. The owner could also not avoid paying penalties by relying on the advice of an outside tax consultant specializing in the aviation industry.

Missouri

Common Carrier Exemption

In Five Delta Alpha, LLC v. Director of Rev., No. 11-1721 RS (May 13, 2014), the Missouri Administrative Hearing Commission held that a contract carrier operating pursuant to 14 C.F.R. Part 135 qualifies as a common carrier for purposes of Missouri's sales and use tax laws. However, the owner and lessor of the aircraft could not avail itself of the state's exemption for common carriers because the exemption is limited to property purchased by a common carrier, which the owner (lessor) is not. Additionally, the Commission held that the lessor could not claim the state's resale exemption because the aircraft was leased and not actually resold by the lessor to the common carrier lessee.

The Commission's decision that a lease is not a "sale" appears to be inconsistent with Missouri's sales and use tax laws taxing lease payments and providing for a resale exemption for property purchased to lease (see, e.g., MO. CODE REGS. ANN. tit. 12, § 10-108.700(3)(A)), and to court decisions finding leases to be sales under Missouri law. See, e.g., Ronnoco Coffee Co., Inc. v. Director of Rev., 185 S.W.3d 676 (2006); Brambles Industries, Inc. v. Director of Rev., 981 S.W.2d 568 (1998).

Exemption for Aircraft Repair Parts and Components Made Permanent

Effective August 28, 2014, all materials, replacement parts and equipment purchased for use directly upon, and for the modification, replacement, repair and maintenance of aircraft, aircraft power plants, and aircraft accessories are exempt from state and local sales and use taxes in Missouri. MO. REV. STAT. § 144.030(2)(41). The above exemption was previously scheduled to sunset on January 1, 2015.

Nevada

Aircraft Used Continuously in Interstate Commerce

In Harrah's Operating Co., Inc. v. Dep't of Tax., 321 P.3d 850 (2014), the Nevada Supreme Court ruled that two of four aircraft acquired by Harrah's were not subject to Nevada use tax because the record evidenced that the two aircraft were first used outside of Nevada and continuously used in interstate commerce for 12 months.

Nevada's use tax laws provide that use tax is due on items of tangible personal property purchased outside the state if purchased for use, storage or consumption in Nevada. However, by statute, there is a rebuttable presumption that an item is not purchased for use in Nevada if the

property is (1) first used outside the state and (2) thereafter used continuously in interstate commerce for at least 12 months.

Harrah's acquired four aircraft outside of Nevada to transport Harrah's executives and customers in interstate and foreign commerce. Two of the aircraft flew directly to Nevada for their first flights. The other two aircrafts' first flights were to states other than Nevada. All four aircraft were stipulated to be used continuously in interstate commerce.

The Nevada Supreme Court ruled the state's statutory "first use" presumption requires first use of the aircraft in interstate commerce entirely outside of Nevada. Accordingly, because two of Harrah's aircraft made their first trips into to Nevada (i.e., the flights terminated in Nevada), these aircraft did not qualify for the statutory presumption that they were not purchased for use in Nevada and were therefore subject to use tax. With respect to the other two aircraft that were first used outside the state in interstate operations (i.e., the aircrafts' first flights originated in one state and terminated in another state before coming into Nevada), the supreme court held that the presumption applied and there was nothing in the record to rebut the parties' stipulation that the aircraft were operated continuously in interstate commerce by Harrah's. Accordingly, the supreme court held in favor of Harrah's with respect to these two aircraft.

The supreme court was careful to point out that its decision applied the state's statue as written (regardless of its wisdom) and that the law with respect to states' taxing of property moving in interstate commerce has changed, but that any expansion of Nevada's statutory use tax laws must come from the legislature.

New Mexico

New Commercial Aircraft Exemption

Effective July 1, 2014, a deduction is allowed from a seller's gross receipts for the sale of commercial or military aircraft with a gross landing weight that exceeds 10,000 pounds. N.M. STAT. ANN. § 7-9-62.1.

New Aircraft Maintenance Service and Parts Exemption

Effective July 1, 2014, a deduction is allowed from a seller's gross receipts for sales of aircraft parts and maintenance services for aircraft and aircraft parts. N.M. STAT. ANN. § 7-9-62(C).

Ohio

Part 135 Carrier Not a Public Utility

In Epic Aviation, LLC v. Tax Comm'r of Ohio, No. CA2012-1557 (Sept. 3, 2014), the Board of Tax Appeals held that a cargo air carrier operating pursuant to 14 C.F.R. Part 135 did not meet the definition of a "public utility" under Ohio law (which would entitle the company to certain sales and use tax exemptions) because the carrier is not subject to the degree of governmental control, oversight and regulation required of public utilities in the state. The Board in support of its holding noted that the carrier did not hold a certificate of convenience and public necessity issued under 49 U.S.C. section 41102 (although not a federal or state requirement), and was subject to less rigorous governmental regulation than carriers operating under 14 C.F.R. Part 121. The Board was without authority to address the company's constitutional arguments.

Texas

Helicopter Qualified for Common Carrier Exemption

In Cirrus Exploration Co. v. Combs, No. 03-13-00036-CV (3d Dist. 2014), the Texas Court of Appeals held that a helicopter owner authorized by the Federal Aviation Administration (FAA) to conduct transportation for hire under 14 C.F.R. Part 91.147 qualified for a sales and use tax exemption for aircraft sold to a person using the aircraft as a certificated or licensed carrier of persons or property. TEX. TAX CODE ANN. § 151.328(a)(1). The Comptroller argued that the aircraft purchase did not qualify for the common carrier exemption because the owner was not certificated to operate the aircraft pursuant to 14. C.F.R. Part 121, 125 or 135. The court held that certification under Part 121, 125 or 135 of the Federal Aviation Regulations (FARs) was not a requirement of the common carrier tax exemption, which simply requires authorization by the FAA to operate as a common carrier transporting persons or property for hire, which the aircraft owner met by holding an FAA letter of authorization allowing for certain transportation for hire pursuant to FARs section 91.147 for helicopters used for sightseeing, aerial photography and surveying flights.

Wisconsin

Two New Sales and Use Tax Exemptions for Aircraft

1. Sales of aircraft parts: Effective July 1, 2014, the sales of and the storage, use, and consumption of parts used to modify or repair aircraft are exempt from Wisconsin sales and use tax pursuant to WIS. STAT. ANN. § 77.54(5)(a)(3).

2. Services to aircraft and aircraft parts: Effective July 1, 2014, charges for the repair, service, alteration, fitting, cleaning, painting, coating, towing, inspection and maintenance of any aircraft or any aircraft parts are not subject to Wisconsin sales tax pursuant to WIS. STAT. ANN. § 77.52(2)(a)(10).

No exemption certificates are needed for these exemptions to apply.

If you have questions regarding this article, please contact **David P. Dorner** at +1 (312) 609 7764 or any other Vedder Price attorney with whom you have worked.