

TAX MATTERS

A newsletter dedicated to informing California Aircraft and Vessel owners about taxes

Prepared and distributed by Aero & Marine Tax Professionals

Misapplying Board annotations will result in a tax liability.

A recent case demonstrated how taxpayers can be at a disadvantage when it comes to understanding how to legally avoid sales/use tax. The taxpayer purchased his aircraft outside the State of California and intended to support a claim for exemption based on commercial use in his own business.

Since the aircraft was registered to taxpayer's California address, the Department asked him to submit records to determine if the aircraft was purchased for use in California. California Code of Regulations, title 18, section (Regulation) 1620, subdivision (b)(4), provides that where an aircraft is purchased from a retailer outside California, first functionally used outside California, and brought into California within 90 days after its purchase, it will be presumed that the aircraft was purchased for use here, unless during the six-month period immediately following California entry, the aircraft is used or stored outside California one-half or more of the time, or one-half or more of the flight time traveled by the aircraft is commercial **flight** time traveled in interstate commerce. It defines the term "commercial" as applying to business use and excluding personal use.

To show the use of the aircraft after taking delivery out-of-state, taxpayer submitted aircraft flight logs, a credit card statement, receipts for fuel purchases, hotel stays and rental cars and letters from clients outside California that taxpayer visited for business purposes. Taxpayer operates a store doing business in California.

The records indicate that, after taxpayer took delivery of the aircraft, it was flown to another state where taxpayer visited a potential customer, to provide an estimate for installation of a system. Thus, the aircraft was first functionally used outside California for commercial purposes. The aircraft was

then flown to Arizona and entered California on August 3, 2005, within 90 days of the purchase date.

During these flights, taxpayer also received flight training from a certified instructor. For the next six months after California entry (between August 3, 2005, and February 3, 2006), the aircraft was flown a total of 100 hours. Of this total, 47 were commercial flight time in interstate. The remaining 53 hours were flight time in California, which included 8 hours of additional flight instruction that taxpayer received from a certified instructor. Thus, since the California flight time at 53 percent exceeded the commercial flight time in interstate commerce at 47 percent, the use of the aircraft did not meet the requirement in subdivision (b)(4)(B)3. of the regulation, that one-half or more of the flight time must be commercial flight time in interstate commerce.

Taxpayer disagreed that the hours of flight instruction in California should be included in the hourly calculations for purposes of determining whether the requirements of the exemption are met. In substance, taxpayer argued that if those hours are removed, then total flight time would be hours less.

As support, taxpayer relied on Annotation 325.0002 (4/29/94) which provides as follows:

"Aircraft - In-State Pilot Training. Use tax does not apply to the use of an aircraft purchased out of state and brought into this state within 90 days of purchase and used solely in interstate commerce for the six month [sic] period following its first entry into California. In-state training flights in aircraft will not affect the availability of the exemption if the flights are for the purpose of training personnel who will fly that specific aircraft, as contrasted to that type of aircraft."

Taxpayer argued that the annotation should be applied here because when it was published in 1994, Regulation 1620 only addressed property used continuously in interstate commerce. The regulation was then amended in 2000 to allow an exemption for aircraft used principally in interstate commerce. As

such, taxpayer believes that the same rule should be applied whether an aircraft is used exclusively or principally in interstate commerce. Taxpayer argues that the basis for determining intent and the availability of the exemption should not differ simply because the regulation allows for different types of interstate commerce exemptions.

The BOE argued that the annotation does not apply because it makes reference to an aircraft that is used solely in interstate commerce. In this case, the aircraft was not used solely or principally in interstate commerce.

The BOE document stated:

“As a preliminary matter, we note that the test at issue here is a different test than the test for continuous use in interstate commerce, which is based on a constitutionally required exemption (Rev. & Tax. Code, § 6352), to which the annotation applies. We have reviewed the language in subdivision (b)(4)(B)3. of Regulation 1620 which addresses the six month test at issue here. It states that use tax will not apply to the use of an aircraft if “one-half or more of the flight time traveled by the aircraft during the six-month period immediately following its entry into the state is commercial flight time traveled in interstate or foreign commerce.” (Italics added.)

In other words, for purposes of applying the six-month test under subdivision (b)(4)(B)3., *total flight time traveled by the aircraft* (which includes flight time for training) must be included in the flight time calculations. Therefore, the test requires a comparison of all flight time against commercial flight time in interstate commerce and if one-half or more of the flight time was commercial flight time in interstate commerce, the requirements for the exemption are met. Thus, since the test at issue requires that time for flight training must be included and annotation applies to a different exemption and test entirely, it is not applicable here.

Moreover, we have reviewed the back-up letter to the annotation at issue (exhibit 1). The letter and annotation are based subdivision (b)(2)(B)1. of Regulation 1620, which provides as follows: “In General. Use tax does not apply to the use of property purchased for use and used in interstate or foreign commerce prior to its entry into this state, and thereafter used continuously in interstate or foreign commerce both within and without California and not exclusively in California.”

In the letter it states that, “We have previously concluded that training flights are incidental to interstate use provided the aircraft is *otherwise used continuously in interstate commerce.*” (Italics added.) In other words, the letter specifically states that the rule for allowing training flights would only apply where the remaining use of the aircraft was continuous use in interstate commerce (i.e. not the test at issue here).

Therefore, in addition to the fact the rule does not apply here (since a different test is involved), the rule is further limited to situations where the training flights are incidental, and the use of the aircraft for such purposes would otherwise destroy the basis for obtaining the exemption for continuous use in interstate commerce.

Thus, in addition to the fact the rule does not apply here, the rule does not even apply to all situations where a taxpayer claims *continuous* use in interstate commerce. Accordingly, since the aircraft entered California within 90 days of purchase and the use of the aircraft after entry has not satisfied either six-month test in subdivision (b)(4) of regulation 1620, use tax is due. (Rev. & Tax. Code, §~ 6201, 6202.)”

If you plan to attempt to support a claim for an exemption from sales/use tax we strongly suggest you contact our office prior to the purchase. This claim could have been supported had the taxpayer known ALL the details correctly.



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916-691-9192