

TAX MATTERS

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

Prepared and distributed by Aero & Marine Tax Professionals

Misunderstanding Will Double Your Tax

By Thomas A. Alston

If you have been overwhelmed by articles, advertising and friendly advice about the various schemes to legally avoid California Sales and Use Tax, let me set you straight about how to protect yourself.

First, you must know that your purchase of an aircraft or vessel is not exempt from tax until the California State Board of Equalization (Board) sends you a letter which affirms in writing your transaction is exempt. This may seem a little simplistic, but every month I encounter another taxpayer (the Board's term for you) who has never filed a tax return, yet firmly believes he/she does not owe tax.

In this case, NO NEWS IS BAD NEWS.

The key to this warning is the fact that the burden of proof in supporting a claim for an exemption rests squarely on your shoulders. The Board does not have to prove anything. The taxpayer has to support the claim for an exemption and must file a tax return. Just because you know that your property was used in an exempt manner does not mean that it is exempt. You must have in your possession a document from the Board which affirms they agree you have supported your claim.

In California, when you purchase an aircraft or vessel from someone other than a retailer who collects sales tax from you at the time of the transaction, it is the legal obligation of the purchaser (you) to timely file (self report) a tax return. In general the return is due within twelve months from the date of the transaction.

If you received an inquiry letter from the Board, the due date is located in the top right hand section of the cover letter. The due date on the letter becomes the date the return must be filed and many times is less than twelve months from the date of the transaction.

If you took possession outside the state using an off-shore delivery for a vessel or an out-of-state delivery for an aircraft, it is your legal obligation to timely file a tax return. If you believe your aircraft is exempt because it has been used in a manner that you were told made it non-taxable, your purchase is NOT EXEMPT FROM TAX until you have filed a tax return and received written notification from the Board that you have supported a claim for exemption.

Even if you made your purchase 5-6 years ago, your transaction is not exempt if you do not possess a letter from the Board which affirms you have supported your claim for exemption. Do not be lulled to sleep by the fact that you have not been contacted by the Board. They know they have approximately 9 years after your transaction to legally notify you that you have been assessed tax.

The Board will find you through property tax assessments or during a routine audit of a California retailer who sells you fuel. They do not have to be in a hurry to notify you they are aware of your property. As long as they notify you before the statute runs out they can collect the tax. Imagine getting a notice seven years and eleven months after the tax return due date. You will not only be assessed tax but penalties and interest as well. This will easily double the amount you originally owed.

The Board is in control if you fail to file a tax return. The following example is intended to point out the danger:

John Smith purchases an aircraft for \$1,000,000.00 on March 12, 1995. The tax rate in his county is 8%. Therefore, the potential tax is \$80,000.00. Mr. Smith registers his aircraft in the name of an out-of-state corporation called Smith Investing, Inc. The corporation was advised that if the aircraft was used in charter operations more than fifty percent of the time it would be exempt from tax. Because the aircraft is registered to an out-of-state address, Mr. Smith believes he has no obligation to file a tax return. During the period of March 1995 through March 1996 the aircraft is in fact

used in an exempt manner by being flown on bonafide charter flights more than 50% of the time.

In June 1997, the aircraft is picked up by the county property tax personnel on a random unannounced visit to an airport. The Board runs the tail number through the FAA registration database and discovers the name of Smith Investing, Inc. A further check of the public records reveals a link to John Smith of California. Mr. Smith is now on the radar screen of the Board auditors.

It is the opinion of the Board auditor that a tax return was due by the end of February 1996. He operates from the viewpoint that the statute of limitations will expire in March 2004. (During the late 90's there was little pressure to assess tax in this type of case. There was no budget crisis. Therefore, Mr. Smith is not contacted.) A reminder flag is set in his file to make sure a notification form is sent to Smith Investing, Inc. before the statute runs out in 2004.

In early 2000, Smith Investing, Inc. sells the aircraft and purchases another.

In December 2002, because of the budget crisis, an inquiry letter is sent to Smith Investing, Inc. at John Smith's address in California. Mr. Smith ignores the inquiry because he still operates from the belief the out-of-state registration, plus the charter use exempts the aircraft from tax in California.

On November 7, 2003, the Board issues a Notice of Determination for the original \$80,000.00 in tax, an \$8,000.00 penalty for failure to file plus \$65,600.00 in interest. Mr. Smith does not respond. Therefore, on December 8, 2003, the bill goes final.

The collections section at the Board make several attempts to contact Mr. Smith and he continues to ignore them. The Board subsequently files a lien against Smith Investing, Inc. Finally, Mr. Smith hires an attorney to deal with the Board. The attorney discovers that once the bill has gone final, the only way Mr. Smith can get the opportunity to support his claim for an exemption is to pay the \$153,000.00 and file a claim for refund.

During the research process to gather the documents which support the exemption, Mr. Smith discovers that the documents were destroyed or lost because no one in the organization thought there was any exposure. Therefore, the assessment will stand. Mr. Smith's misunderstanding of the laws and regulations have converted a tax exempt purchase into a taxable

transaction and doubled the price!

This story is a compilation of several stories I come across every day.

DON'T LET IT HAPPEN TO YOU. If you have the slightest discomfort about your tax status for purchases you have made any time in the last ten years, I will offer a free analysis of your situation.

Don't hesitate to protect yourself.