Avoiding Surprises

Anticipating the tax-related costs of your homebuilt aircraft

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CONGRATULATIONS! YOU'VE DEcided to build your own aircraft. As you surf the web or page through the latest issue of *EAA Sport Aviation* in search of the perfect homebuilt, remember that aviation-related state taxes will most likely contribute to the cost of your project. Being unprepared for a 4-percent sales tax can be an unpleasant surprise that wreaks havoc on your construction schedule as well as your pocketbook.

Sales Tax

Sales tax is a tax on gross receipts from the sale of tangible personal property (including aircraft and aircraft parts) and certain services by a state in which the sale of such property or services occur. In most cases the buyer pays and the seller collects the tax, but in some states (such as Arizona), the tax is imposed directly on the seller as a transaction privilege tax.

Sales tax rates and rules vary by state, and four states have no general sales tax: Alaska (except for certain local taxes), Montana, New Hampshire, and Oregon. Some states, such as Delaware, have retailer, wholesaler, or lease taxes. North and South Carolina have limits on the amount of aircraft sales tax, and Oklahoma has an aviation excise tax on the transfer of aircraft ownership in lieu of a tax on sales. Massachusetts recently enacted a blanket exemption to sales and use tax for all aircraft, aircraft parts, and services.

In addition to the sales tax on aircraft, many states have special rules regarding the sale of aircraft parts and equipment, and labor costs may be taxable in certain states. California, for example, imposes no sales or use tax on repair and installation labor, but it does tax fabrication and assembly labor. In many states aircraft repair and maintenance labor is not subject to sales tax when it's invoiced separately. Whether owner labor is taxable may depend on the intended ultimate use of the aircraft. If it's personal use there may be a different tax than if the owner intends to sell the finished product.

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All these sales tax scenarios are based on the seller and the purchaser being in the same state. Several possibilities exist when seller and purchaser are from different states. Many states have "flyaway exemptions" for property being purchased by an out-of-state buyer. In some states this specifically applies to aircraft manufactured or assembled within the state. This usually requires the purchaser to provide some sort of claim for exemption to the seller. However, in the case of an aircraft, that does not mean that the buyer is off the hook as far as taxes are concerned.

Use Tax

A use tax applies to the use, storage, and consumption of tangible personal property in a state. States generally overlook small purchases bought in another state that are brought back for use within their borders. But big ticket items such as aircraft, automobiles, and boats are usually taxed in the state in which they are used. Use tax is generally based on the item's fair market value. This can be tricky when evaluating a homebuilt aircraft. Does the value of your labor add to the fair market value? Does a partially built aircraft's value include labor costs, or does only a fully operational one include such costs?

Use is usually broadly defined to include the exercise of a right or power over the property and the direct or indirect benefit of a taxable service. This means use can include mere presence, while being stored, repaired, or assembled within the state. States generally impose use tax directly on the consumer; however, vendors with sufficient connection to the buyer's state (in tax lingo this is called nexus) may be required to collect that state's use tax.

Because every state with a general

sales tax also has use tax, use tax is said to complement sales tax. In most cases this means that if a consumer has not paid a sales tax on the purchase of an item, he or she will pay a use tax in the state where it is used or kept, unless an exemption applies.

States have various methods of determining when to trigger use tax. In some states, such as California, if property is brought into the state within a certain period from the date of purchase, it is presumed to be for use in the state. In other states any storage, use, or consumption within the state, not subject to sales tax, is subject to use tax unless a specific exemption applies.

Other potential exemptions that may apply to homebuilt aircraft include casual or isolated sale exemptions (which may apply to sales by persons not in the business of selling that type of property) and sale for resale (which may apply to professional builders). Beware states that have low dollar limits on casual or isolated sales and those that specifically disqualify aircraft from the exemption.

States that impose sales and use tax often give credit for taxes paid in other states. If sales tax is paid in the state where the aircraft was purchased and use tax is owed in the state where it is stored, the storage state will generally credit the sales tax paid. If the use tax rate is higher, you will likely be required to pay the difference between the two in the state where the use tax is imposed.

Personal Property Tax

Administered by their counties, many states impose a tax on personal property separate from sales or use tax, and the rates may vary from county to county. Whether a tax applies may depend on such factors as the aircraft's operational status, where it's located on a particular assessment date, and, once the aircraft is operational, its habitual or periodic location. Some states exempt aircraft used for personal purposes from property tax, but other states, such as Kansas, only exempt aircraft used in a business from such taxes. Once your homebuilt aircraft is operational, you must consider other taxes.

Registration Fees

Some states impose registration fees on resident aircraft owners and owners who locate their aircraft in the state for a certain time. Depending on the state, this is either a flat fee or one determined by a formula based on factors such as value, age, weight, or aircraft type. Oregon imposes a special category of registration for homebuilt aircraft and a separate category for ultralights. Washington, Mississippi, and Montana have flat registration fees for homebuilts. In many states the registration fee is imposed in lieu of property tax; however, some states, such as Virginia, impose both the registration fee and a property tax.

Leases

Although FAA operating limitations on homebuilt aircraft have generally prevented homebuilt owners from leasing their equipment, recently some beneficial changes have been allowing owners of homebuilt aircraft to rent out their aircraft (for compensation) for transition training and flight reviews.

Many states consider leases to be taxable sales. In some of these states the purchase of property used exclusively for lease is exempt as a sale for resale, and the lessor is required to collect the taxes (either sales or use tax depending on the state and the circumstances) from the lessee at the time each lease payment is made. Still other states consider a lease as a sale, but impose a tax at the inception of the lease on the total purchase price of the aircraft or the total amount of the lease payments for the term of the lease.

Problems may arise if a lessee moves from a state where lessors are required to pay sales tax at the inception of the lease for the entire term of the lease (New Jersey is an example) to another state (say Vermont) that taxes the lessee on each lease payment as it is made. Taxes will be due in Vermont with no credit available for taxes already paid for the same period in New Jersey.

Fuel Taxes

Most states collect taxes on aviation fuel—gasoline, avgas, and jet fuel. In general, most of these taxes are paid at the pump. Tax rates vary widely from state to state.

A tax professional can also be a good source of information for advice in this area.

As you can see from this general overview, aviation-related taxes can be confusing (even for tax professionals). Identifying what state taxes apply to you should be your first priority when planning for such taxes. There are several sources of information, and most state revenue departments maintain websites that include information, publications, forms, and contacts for tax questions. (Our website, at *www.coolinglaw.com*, provides links to many of these sites.)

Finally, a tax professional can also be a good source of information for advice in this area. In any event, careful planning is a good way to prevent a surprise tax bill from derailing your plans to build that aircraft of your dreams.

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