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## NON-COMMERCIAL AIRCRAFT SALES— PLANNING STRATEGIES TO ENSURE FAA COMPLIANCE AND MINIMIZE TAXES

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Individuals and entities purchasing, owning and operating personal aircraft for non-commercial use face a myriad of regulatory compliance issues, including meeting Federal Aviation Administration (FAA) and state and federal tax requirements. A natural impulse for many clients when purchasing an aircraft is to form an entity to take title to the aircraft. The use of an entity seems logical for (i) liability protection, (ii) administration and accounting, and (iii) tax minimization. Generally, clients gravitate towards forming such an entity in states without sales or use tax to take delivery of the aircraft. This article discusses the potential pitfalls of forming an entity to take title to non-commercial aircraft.<sup>1</sup> It presents the proper steps necessary to comply with FAA regulations, and reviews the various taxing schemes of certain western states.<sup>2</sup>

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<sup>1</sup> See *infra* notes 3–70, 78–81 and accompanying text.

<sup>2</sup> See *infra* notes 3–77, 84–103 and accompanying text.

## I. PART 91, PART 135 AND THE FLIGHT DEPARTMENT COMPANY PROBLEM

Part 91 of the FAA regulations governs the operation of small, non-commercial aircraft in the United States.<sup>3</sup> Most clients who purchase aircraft for personal or business use fall within the parameters of coverage offered by Part 91. In order for an aircraft operator to use an aircraft for hire (i.e., a commercial operator), he or she must obtain a commercial license, at which point the operation of such aircraft is governed by Part 135 of the FAA Regulations.<sup>4</sup> Part 135 provides a set of rules with more stringent standards for commercial operations than Part 91 offers for commuter operations.

An aircraft commercial operator is a person hired for the sole purpose of transporting persons or property.<sup>5</sup> Such definition raises a key issue in personal aircraft ownership: If a client establishes an entity to hold title to an aircraft for the purpose of personal use and the transportation of owners and guests, is that entity engaging in a “major enterprise for profit” as defined under Part 91?<sup>6</sup> According to numerous FAA Legal Interpretations and Chief Counsel’s Opinions, the answer is: Yes.<sup>7</sup> Simply put, aircraft operations cannot be “incidental” to any other operation if the sole purpose of the entity is to own and operate the aircraft.<sup>8</sup> Although it is not defined in any regulation, the FAA refers to such

<sup>3</sup> 14 C.F.R. §§ 91.1–91.1507 (2008).

<sup>4</sup> §§ 135.1–135.507.

<sup>5</sup> § 1.1. A commercial operator is defined as:

[A] person who, for compensation or hire, engages in the carriage by aircraft in air commerce of persons or property . . . . Where it is doubtful that an operation is for ‘compensation or hire’, the test applied is whether the carriage by air is merely incidental to the person’s other business or is, in itself, a major enterprise for profit.

*Id.*

<sup>6</sup> *See id.*

<sup>7</sup> *See infra* note 9 and accompanying text; Letter from Chief Counsel, FAA, to Joseph A. Kirwan, Ogden, Newell & Welch, PLLC (May 27, 2005), available at [http://www.faa.gov/about/office\\_org/headquarters\\_offices/agc/pol\\_adjudication/agc200/interpretations/data/interps/2005/Kirwan.rtf](http://www.faa.gov/about/office_org/headquarters_offices/agc/pol_adjudication/agc200/interpretations/data/interps/2005/Kirwan.rtf) (last visited Nov. 21, 2009); David T. Norton, *Don’t Put Your Client’s Shiny New Corporate Jet Into a Sole-Asset LLC*, 65 TEX. BAR J. 314, 314 (2002); Jeff Wieand, *Your Client vs. the FAA: The Flight Department Company Trap*, 12 ABA BUS. L. TODAY 38, 39 (Mar./Apr. 2003); *see also* Letter from Kenneth P. Quinn, Chief Counsel, FAA, to the Honorable Wendell L. Wilkie, II, General Council, Department of Commerce (June 16, 1992), available at [http://www.faa.gov/about/office\\_org/headquarters\\_offices/agc/pol\\_adjudication/agc200/interpretations/data/interps/1992/W.Willkie.rtf](http://www.faa.gov/about/office_org/headquarters_offices/agc/pol_adjudication/agc200/interpretations/data/interps/1992/W.Willkie.rtf) (last visited Nov. 21, 2009).

<sup>8</sup> 14 C.F.R. § 91.501(b)(5):

Operations that may be conducted under the rules in this subpart instead of those in parts 121, 129, 135, and 137 of this chapter when common carriage is not involved, include— . . . (5) Carriage of officials, employees, guests, and property of a company on an airplane operated by that company, or the parent or a subsidiary of the company or a subsidiary of the parent, when the carriage is within the scope

a single purpose entity as a “flight department company.”<sup>9</sup> The determination that an entity is a “flight department company” will remove an operation from Part 91 to the more stringent operating rules of Part 135. For example, in the FAA Assistant Chief Counsel Opinion (Opinion) issued on March 9, 2007, a private party wished to form a limited liability company (Company) for the purpose of owning and operating an aircraft.<sup>10</sup> The owner of the Company made contributions to the Company which were used to pay the costs of owning and operating the aircraft.<sup>11</sup> The aircraft was used solely for the transportation of the client, client’s family members, and guests.<sup>12</sup> The FAA declared the Company a “flight department company” and disallowed the aircraft’s operation under Part 91.<sup>13</sup> The conclusion made by the FAA was that contributions made by the client to the Company used to fund the operating expenses of the aircraft were regarded as “compensation.”<sup>14</sup> Based upon this reasoning, clients are barred from forming a special purpose “flight department company” to take title to an aircraft because contributions to the entity to pay expenses would be deemed compensation, and thus remove the client from regulation under Part 91 and into Part 135.<sup>15</sup>

The flight department company rule prohibits operation, not the mere ownership of aircraft for personal use by individuals or the joint ownership by several entities leasing aircraft to third parties.<sup>16</sup> Therefore, a properly structured joint ownership arrangement of an aircraft is a practical solution to meeting the flight department company rule.<sup>17</sup> Under the advice and oversight of an attorney familiar with FAA regulations, a group of individual clients can jointly own and operate an aircraft for personal purposes without running afoul of the flight

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of, and incidental to, the business of the company (other than transportation by air) and no charge, assessment or fee is made for the carriage in excess of the cost of owning, operating, and maintaining the airplane, except that no charge of any kind may be made for the carriage of a guest of a company, when the carriage is not within the scope of, and incidental to, the business of that company . . . .

<sup>9</sup> Letter from Rebecca B. MacPherson, Assistant Chief Counsel, FAA, to James W. Dymond, Esq., Moore & Van Allen, PLLC (Mar. 9, 2007), *available at* [http://www.faa.gov/about/office\\_org/headquarters\\_offices/agc/pol\\_adjudication/agc200/interpretations/data/interps/2007/James%20Dymond.pdf](http://www.faa.gov/about/office_org/headquarters_offices/agc/pol_adjudication/agc200/interpretations/data/interps/2007/James%20Dymond.pdf) (last visited Nov. 21, 2009) (responding to a request for guidance as to whether the entity at issue would be a “flight department company,” Ms. MacPherson replies “Yes, as that phrase has been used in FAA interpretations.”).

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* The term “compensation” is not defined in Part 91. However, the finding that the operator was receiving compensation brought the operator within the definition of a “commercial operator” and out of the Part 91 operating rules. *See* 14 C.F.R. § 1.1 (defining commercial operator).

<sup>15</sup> *See supra* note 4 and accompanying text.

<sup>16</sup> 14 C.F.R. § 91.501(a) (“This subpart prescribes *operating* rules, . . . .”) (emphasis added).

<sup>17</sup> *See* 14 C.F.R. § 91.501(b)(6).

department company problem. Such individual clients could each form an entity to own a portion of the aircraft, but the newly formed entities would be barred from “operating” the entity under the flight department company rule. Instead, the more practical solution for a group of individual clients wishing to jointly own and operate an aircraft is simply to enter into a dry lease with a separate operating entity.<sup>18</sup>

## II. FEDERAL EXCISE TAX

A major tax concern of owning and operating a personal aircraft is the application of the federal excise tax (FET).<sup>19</sup> Private business aircraft operators are required to pay FET on either fuel or the transportation of persons or property.<sup>20</sup> The FET applied to the transportation of persons or property is a percentage tax on the amount paid for commercial transportation, while the FET on fuel is a cents-per-gallon tax.<sup>21</sup> Effective October 1, 1999, the Internal Revenue Code imposes a 7.5% excise tax upon taxpayers providing air transportation services to persons.<sup>22</sup>

For the most part, private operators falling under the parameters of Part 91 are subject to the fuel tax on non-commercial aviation, while commercial operators operating within the parameters of Part 135 are subject to the tax on the transportation of persons or property. However, the status of commercial or noncommercial operators differs from the industry status for tax purposes.<sup>23</sup> Revenue Ruling 78-75 dictates that the status of an aircraft operator as a “commercial operator” under FAA regulations does not determine the commercial

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<sup>18</sup> See, e.g., 14 C.F.R. § 91.1001(b)(2) (“A dry-lease aircraft exchange means an arrangement, documented by the written program agreements, under which the program aircraft are available, on an as needed basis without crew, to each fractional owner.”).

<sup>19</sup> See generally I.R.C. § 4261 (2006).

<sup>20</sup> See IRS PUBLICATION 510, EXCISE TAXES (INCLUDING FUEL TAX CREDITS AND REFUNDS) (Revised Apr., 2009), available at <http://www.irs.gov/pub/irs-pdf/p510.pdf> (last visited Nov. 21, 2009).

<sup>21</sup> For a helpful website pertaining to the FET as applied to aircraft, see National Business Aviation Association, <http://www.nbaa.org>.

<sup>22</sup> I.R.C. § 4261(a).

<sup>23</sup> As noted in note 5, the FAA defines the term “commercial operator” as:

[A] person who, for compensation or hire, engages in the carriage by aircraft in air commerce of persons or property . . . . Where it is doubtful that an operation is for ‘compensation or hire’, the test applied is whether the carriage by air is merely incidental to the person’s other business or is, in itself, a major enterprise for profit.

14 C.F.R. § 1.1 (2008). However, the Internal Revenue Service defined the term “commercial operator” as: “Anyone in the business of transporting persons or property for compensation or hire by air.” I.R.C. § 4041(c) (2006).

or noncommercial status of the operator in the application of the aviation fuel and air transportation taxes.<sup>24</sup>

Generally speaking, when an individual owns his or her own aircraft and uses it to fly persons for personal enjoyment, such operation of the aircraft is not deemed a taxable event for purposes of FET.<sup>25</sup> However, any commercial operation of an aircraft, including flying persons or property for hire, for payment, or for some type of service rendered in exchange for the flight is subject to FET.<sup>26</sup>

In reality, there is a fine line in determining whether a personal aircraft is operating as a commercial or non-commercial aircraft and such determination is extremely important to aircraft ownership. If an aircraft is not flying in compliance with FAA regulations due to its lack of appropriate certification, the aircraft's owner runs the risk of hefty FAA fines and aircraft insurance coverage could be denied. The FAA issues fines for every flight taken under a Part 91 certificate when a Part 135 certificate is actually required.<sup>27</sup> The dollar amounts of these fines can be extraordinary.<sup>28</sup> Adding insult to injury, the denial of insurance coverage generally arises from a standard clause in aircraft insurance policies requiring that the aircraft operate in compliance with FAA regulations in order to maintain insurance coverage. Therefore, it is not only vitally important to determine whether a client is acting as a commercial or non-commercial aircraft operator, it is also essential to determine whether the FET will apply to such transportation of persons or property for tax purposes.

### III. SALES AND USE TAX IMPLICATIONS

In any outright purchase or leasing structure involving non-commercial aircraft, various state taxes play a significant role in logistical planning.<sup>29</sup> Specifically, the area of multistate sales and use tax must be considered in the purchase or lease of a personal aircraft. Generally, sales tax is a tax applied at the

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<sup>24</sup> Rev. Rul. 78-75, 1978-1 C.B. 340.

<sup>25</sup> Rev. Rul. 84-12, 1984-1 C.B. 211 (stating that where there is no amount paid for air transportation, the amount is not subject to the percentage tax).

<sup>26</sup> See I.R.C. § 4261(a) (stating in general, any amounts paid for the air transportation of person are subject to tax). See generally INTERNAL REVENUE SERVICE, INTERNAL REVENUE SERVICE EXCISE TAX—AIR TRANSPORTATION AUDIT TECHNIQUES GUIDE (ATG) (Revised Apr. 2008), available at [http://www.irs.gov/pub/irs-mssp/air\\_transportation.pdf](http://www.irs.gov/pub/irs-mssp/air_transportation.pdf) (last visited Nov. 21, 2009).

<sup>27</sup> See 14 C.F.R. § 13.305(d) (2009).

<sup>28</sup> *Id.* (establishing fines up to \$11,000 for each violation of an aircraft operating under a Part 91 certificate when it should be operating under a Part 135 certificate).

<sup>29</sup> Although not discussed in great detail in this article, taxes must be considered and addressed at the state level, as well as the local level, when advising clients on the purchase or lease of an aircraft.

point of sale on tangible personal property and certain enumerated services.<sup>30</sup> Use tax is generally an excise tax applied in lieu of sales tax on the use, storage or consumption of goods within a state, regardless of when the actual sale took place.<sup>31</sup> Use tax is generally imposed at the same rate as the state's statutory sales tax rate.<sup>32</sup> Because state statutes and regulations regarding sales and use tax are not universal, understanding the various state sales and use tax implications is imperative when devising planning strategies for high net-worth sales.

In 2000, a nationwide effort to align the states' sales and use tax rules was established via the Streamlined Sales Tax Project (SSTP).<sup>33</sup> The SSTP's main objective is to simplify and modernize sales and use tax collection and administration in the United States by creating a set of universal rules called the Streamlined Sales and Use Tax Agreement (Agreement).<sup>34</sup> As not every state has adopted the measures drafted in the Agreement, an understanding of the sales and use tax statutes in all applicable jurisdictions associated with a sale or lease of personal aircraft is essential.

Because an aircraft is tangible personal property, states tend to impose sales and use tax on personal aircraft sales.<sup>35</sup> Depending upon the state's statutory requirement, sales tax is generally due based on the location of the sale.<sup>36</sup> Additionally, sales tax is imposed on the retailer, which then remits the tax directly

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<sup>30</sup> See, e.g., WYO. STAT. ANN. § 39-15-103(a)(i)(A), (J) (2009); COLO. REV. STAT. § 39-26-106(1)(a), (c) (2009); UTAH CODE ANN. § 59-12-103(1)(a), (b) (2009). Each statute discusses the imposition of sales tax within the state.

<sup>31</sup> See WYO. STAT. ANN. § 39-15-103(a)(i), (c)(i).

<sup>32</sup> See, e.g., WYO. STAT. ANN. § 39-16-104(a) (2009) (imposing the use tax at the same rate as state sales tax).

<sup>33</sup> For more information pertaining to the Streamlined Sales Tax Project, see Streamlined Sales Tax Governing Board, Inc., <http://www.streamlinedsalestax.org>.

<sup>34</sup> The goal of SSTP is to unify state sales tax systems. In two United States Supreme Court cases, *Bellas Hess v. Illinois*, 386 U.S. 753 (1967) and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), it was determined that a state may not require a seller without nexus in the state to collect sales tax on the sale. The United States Supreme Court found the existing sales tax system too complicated to impose upon a business which lacks nexus. The Court further determined Congress has the authority to allow states to require remote sellers to collect tax. The result of these two key cases is the Streamlined Sales and Use Tax Agreement (Agreement). The purpose of the Agreement is to simplify the administration of sales and use tax among the states.

<sup>35</sup> See, e.g., WYO. STAT. ANN. § 39-15-101(a)(ix) (2009) (defining "tangible personal property" as all personal property that can be seen, weighed, measured, felt or touched, or that is in any other manner perceptible to the senses. Aircraft falls within such definitions); UTAH CODE ANN. § 59-12-102(108)(a)(i) (2009) (defining "tangible personal property" as all personal property that can be seen, weighed, measured, felt or touched, or that is in any other manner perceptible to the senses, a definition that aircraft fall within).

<sup>36</sup> See, e.g., WYO. STAT. ANN. § 39-15-103(a)(i)(A) (levying sales tax on every retail sale of tangible personal property within the state).

to the state.<sup>37</sup> However, certain key states can be considered tax friendly havens for personal aircraft sales, and strategic planning utilizing these states could mean large tax savings to an aircraft purchaser. Five states—Alaska, Delaware, Montana, New Hampshire and Oregon—do not impose sales or use tax on the sale of tangible personal property or certain enumerated services.<sup>38</sup> Neither Massachusetts nor Rhode Island impose sales or use tax on aircraft sales.<sup>39</sup> Depending upon the aircraft's weight, Connecticut exempts certain aircraft from sales and use tax and Delaware exempts certain aircraft from the state's gross receipts tax.<sup>40</sup> Further, a number of states, including Arizona, Kansas and Nebraska, have certain fly away exemptions, which generally allow that title of an aircraft can transfer within the state with no sales tax imposition, so long as the aircraft is removed from the state within a certain specified period of time.<sup>41</sup>

Wyoming requires sales tax be levied on the purchase price of every retail sale of tangible personal property in the state.<sup>42</sup> Wyoming's sourcing statute details a myriad of sourcing rules for various sales of tangible personal property within in the state.<sup>43</sup> Wyoming also requires persons storing, using or consuming tangible personal property in the state be liable for use tax.<sup>44</sup> Use tax is a tax on the use of goods or certain services within a state when sales tax has not been paid.<sup>45</sup> This tax is generally based on the fair market value of the property at the time of sale.<sup>46</sup> The sourcing rule for use tax in Wyoming is quite similar to the sourcing rule for sales tax in the state, as it covers various and specific transactions upon which use tax would be imposed.<sup>47</sup>

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<sup>37</sup> See, e.g., WYO. STAT. ANN. § 39-15-103(c)(i) (requiring every vendor to collect sales tax).

<sup>38</sup> See ALASKA STAT. § 29.45.650–710 (2009); DEL. CODE ANN. tit. 30, § 2909(l) (2009); MONT. CODE ANN. § 15-6-219 (2007); N.H. CODE ADMIN. R. ANN. §§ 72:1–78, 73:4 (2009); OR. REV. STAT. § 307.190 (2009).

<sup>39</sup> MASS. GEN. LAWS ch. 64H, § 6(vv) (2009); R.I. GEN. LAWS § 44-18-30(56) (2009).

<sup>40</sup> CONN. GEN. STAT. ANN. § 12-412(99) (West 2009) (exempting from sales tax the sale of aircraft weighing 6,000 pounds or more); DEL. CODE ANN. tit. 30 § 2909(l) (exempting from gross receipts tax the sale of aircraft weighing 12,500 pounds or more).

<sup>41</sup> See ARIZ. REV. STAT ANN. § 42-5159(B)(7)(b) (2009); FLA. STAT. ANN. § 212.05(1)(a)(2) (West 2009); KAN. STAT. ANN. § 79-3606(k) (2009) (exempting from sales tax any aircraft sold in the state (i.e., title transferring in Kansas) if the purchaser is a resident of another state and the aircraft is removed from Kansas within ten days of the sale).

<sup>42</sup> WYO. STAT. ANN. § 39-15-103(a)(i)(A).

<sup>43</sup> WYO. STAT. ANN. § 39-15-104 (2009). Sourcing is the process of tracing a sale by the type and location of the sale in order to determine what jurisdiction the tax collected from a transaction is subsequently owed.

<sup>44</sup> WYO. STAT. ANN. § 39-16-103(a)(i) (2009).

<sup>45</sup> See, e.g., WYO. STAT. ANN. § 39-16-103(c)(i)–(ii) (extinguishing the use tax if the taxpayer proves that sales tax on the tangible personal property was paid in another jurisdiction).

<sup>46</sup> See, e.g., WYO. STAT. ANN. § 39-16-103(b) (establishing the basis of use tax in Wyoming).

<sup>47</sup> WYO. STAT. ANN. § 39-16-104 (2009).

Many jurisdictions treat the lease of tangible personal property as a sale for tax purposes.<sup>48</sup> In Wyoming, sales tax applies to the gross rental paid for the lease of tangible personal property, if the transfer of possession would be taxable upon sale.<sup>49</sup> For sales tax purposes, Wyoming statutes further specify that leases of aircraft requiring recurring periodic payments are sourced to the primary property location.<sup>50</sup> For leases not requiring recurring periodic payments, the payment is sourced like a retail sale—at the business location of the seller.<sup>51</sup> In Wyoming, the use tax statutes also specify that leases of aircraft requiring recurring periodic payments are sourced to the primary property location.<sup>52</sup> For leases not requiring recurring periodic payments, the payment is sourced to the business location of the seller.<sup>53</sup>

To understand Wyoming's sales and use tax statutes in a practical scenario, consider a basic sale of personal aircraft from an aircraft broker to a Wyoming resident. For the aircraft sale to be taxable in Wyoming, title of the aircraft must transfer in Wyoming.<sup>54</sup> To properly avoid sales tax on the transaction, a Wyoming resident purchaser may structure the sale so that title of the aircraft transfers in a sales tax friendly haven, such as Montana, which does not impose sales or use tax.<sup>55</sup> However, once the aircraft is brought back into Wyoming for use, the purchaser is subject to use tax at the same rate upon which sales tax would have applied, had the sale taken place in Wyoming.<sup>56</sup> Use tax in Wyoming is calculated based upon when the tangible personal property is first stored, used, or consumed within the state.<sup>57</sup> Wyoming use tax does not apply to tangible personal property which is purchased and used in another state prior to its use in Wyoming.<sup>58</sup>

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<sup>48</sup> See WYO. STAT. ANN. § 39-15-103(a)(i)(B); IDAHO CODE § 63-6612(2)(h) (2009); ARIZ. REV. STAT. § 42-5001(13) (2009).

<sup>49</sup> WYO. STAT. ANN. § 39-15-103(a)(i)(B).

<sup>50</sup> WYO. STAT. ANN. § 39-15-104(f)(ii)(A) (2009). Note that while Wyoming statutes do not define the term “recurring periodic payments,” it is arguable that monthly or yearly installment payments for a particular term would qualify as recurring periodic payments (i.e., \$10,000 payment each year for a lease term of ten years).

<sup>51</sup> WYO. STAT. ANN. § 39-15-104(f)(ii)(B). Note that while Wyoming statutes do not define the term “recurring periodic payment,” it is arguable that a lump sum payment made for a particular term would be denoted as a non-recurring periodic payment (i.e., \$50,000 payment made for a ten year lease term).

<sup>52</sup> WYO. STAT. ANN. § 39-16-104(e)(iii)(A).

<sup>53</sup> WYO. STAT. ANN. § 39-16-104(e)(iii)(B).

<sup>54</sup> See WYO. STAT. ANN. § 39-15-103(a)(i)(A).

<sup>55</sup> See MONT. CODE ANN. § 15-6-219.

<sup>56</sup> See WYO. STAT. ANN. § 39-16-104(a).

<sup>57</sup> 011-000-002 WYO. CODE R. § 4(i)(ii) (Weil 2009).

<sup>58</sup> § 4(i)(v).

In *In re Ken Koster*, a Wyoming resident who purchased an aircraft out of state for use out of state was not subject to sales or use tax in Wyoming.<sup>59</sup> In *Koster*, the Wyoming resident purchased an aircraft with title transferring in Missouri, and the aircraft was never delivered, used or stored in Wyoming.<sup>60</sup> The Wyoming Board of Equalization found that sales tax did not apply to the sale of the aircraft, as title transferred outside the state of Wyoming.<sup>61</sup> Further, use tax was not imposed because the aircraft was never stored or used within the state.<sup>62</sup> In instances similar to *Koster*, it is arguable that if an aircraft is purchased and used outside of Wyoming, neither sales nor use tax should apply to a Wyoming purchaser. However, special care must be taken in situations where the sale of an aircraft occurs outside of Wyoming but *use* of such aircraft might occur inside the state.

#### A. *Advantages of Lease Transactions*

In scenarios where the sale of an aircraft occurs outside of Wyoming but use of the aircraft occurs within the state, it is advantageous to structure a leasing agreement using tax-friendly states in order to effectively minimize a Wyoming resident's sales and use tax obligations.

To understand the implications of Wyoming's sales and use tax statutes in this particular factual scenario, consider a leasing agreement entered into between a non-Wyoming resident business entity and a Wyoming resident. In this example, a business entity situated in a state with no sales tax (for example, Montana) could purchase an aircraft from a third-party broker and subsequently lease the aircraft to Wyoming residents, resulting in favorable sales and use tax results.<sup>63</sup> In such a transaction, title of the aircraft would successfully transfer outside of Wyoming, while use of the aircraft by the lessee would occur in Wyoming.<sup>64</sup> As noted earlier, for purposes of both sales and use tax the Wyoming sourcing requirements with respect to leases provide that recurring periodic payments are sourced to the primary property location, while payments which are not recurring are sourced

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<sup>59</sup> *In re Ken Koster*, No. 2004-132 (Wyo. Bd. of Equalization Aug. 2005), available at [http://taxappeals.state.wy.us/images/docket\\_no\\_2004132.htm](http://taxappeals.state.wy.us/images/docket_no_2004132.htm) (last visited Nov. 21, 2009).

<sup>60</sup> *Id.* at ¶¶ 9–11.

<sup>61</sup> *Id.* at ¶¶ 30–40 (order).

<sup>62</sup> *Id.*

<sup>63</sup> For favorable income tax results, the non-resident business entity should be organized as a pass through entity and the Wyoming resident lessees should be the members/partners of such entity. For example, the Montana entity could be set up as a Montana LLC and the members of the LLC would be the Wyoming residents who will ultimately lease the aircraft from the LLC.

<sup>64</sup> Title of the aircraft would transfer in Montana upon the sale by the broker to the business entity. Upon the leasing arrangement between the Montana business entity lessor and the Wyoming resident lessees, use of such aircraft would occur in Wyoming.

to the business location of the seller.<sup>65</sup> Hence, structuring a leasing agreement between a non-resident lessor and Wyoming resident lessees requiring a lump sum, non-periodic payment covering a term of years would result in the leasing payment sourced outside of Wyoming for both sales and use tax purposes.<sup>66</sup> Further, structuring a transaction utilizing a leasing agreement between a business entity lessor and a third party lessee, rather than structuring a transaction utilizing an outright purchase of an aircraft by an entity for use, is essential in order to avoid the flight department company rule imposed by the FAA.<sup>67</sup> The flight department company rule bars a single individual from forming an entity for the sole purpose of owning and operating an aircraft, and also disallows a group of individuals from pooling their funds together to form a specific purpose entity.<sup>68</sup>

#### IV. ADDITIONAL CONSIDERATIONS

Other planning considerations associated with the sale or lease of personal aircraft include income and property taxes, as well as title and lien priorities. APPENDIX A below provides a brief outline of the applicable sales, use, income and personal property tax rates in certain states located around or near Wyoming.<sup>69</sup>

Income tax considerations must be accounted for with respect to the sale or lease of personal aircraft. Income tax is a tax levied on the gross income of an individual or business entity.<sup>70</sup> In the outright purchase of a personal aircraft, the seller will be subject to federal and, in many cases, state income tax on the gross income received from the sale of an aircraft.<sup>71</sup> In a thoughtful leasing structure, state income tax obligations can be reduced or eliminated if the lessor's business entity is set up in a state which imposes no income tax.<sup>72</sup>

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<sup>65</sup> See WYO. STAT. ANN. §§ 39-15-104(f)(ii)(A)–(B), 39-16-104(e)(iii)(A)–(B); see *supra* note 38 and accompanying text.

<sup>66</sup> Note, this scenario does not consider the income tax obligations a taxpayer may be subject to in any given state where the lessor and lessees are located. A thorough understanding of a particular state's income tax requirements where such parties are located is imperative to fully understand the tax consequences facing the lessor and lessees in any given scenario. While outside the scope of this article, proper planning can also reduce or eliminate income tax obligations with respect to such parties.

<sup>67</sup> See MacPherson, *supra* note 9 and accompanying text.

<sup>68</sup> *Id.*

<sup>69</sup> See *infra* APPENDIX A, WESTERN STATE TAX MATRIX.

<sup>70</sup> I.R.C. § 61(a) (2006) (defining gross income as all income from whatever source derived).

<sup>71</sup> *Id.* (defining gross income without differentiating between an individual or business entity).

<sup>72</sup> Seven states—Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming—impose no state income tax. Therefore, a tax planner advising a client about the various tax implications associated with the sale or lease of an aircraft must be aware that certain states are more favorable than others with respect to setting up a business entity. Note, however, that while

Property tax is another consideration to keep in mind when selling or leasing personal aircraft. Property tax, also referred to as an ad valorem tax, is a tax on the assessed value of real and certain tangible personal property.<sup>73</sup> Property tax is defined as a “tax imposed by municipalities upon owners of property within their jurisdiction based on the value of such property.”<sup>74</sup> Generally, property tax is imposed at the state level, but can also be imposed at the city or county level.<sup>75</sup> Registration of the aircraft with the FAA at its permanent hanger location will likely dictate which state’s property tax is applicable.

Title and lien priority must also be considered in the sale or lease of an aircraft. Federal law effectively preempts a state’s normal methods of perfection under the Uniform Commercial Code.<sup>76</sup> To perfect an outright interest, security interest, or lease, etc., such instrument must be filed with the FAA, which acts as a central repository for all domestic aircraft commercial transactions.<sup>77</sup> In addition, any aircraft able to transport more than eight people is subject to the Cape Town Treaty adopted by the United States in the Cape Town Treaty Implementation Act of 2004.<sup>78</sup> This treaty recognizes the International Registry of Mobile Assets (International Registry) in Dublin, Ireland, as the central registry establishing title and lien priority on an international level.<sup>79</sup> Any owner of an aircraft covered by the Treaty should register at the International Registry in addition to registration with FAA.

## CONCLUSION

Transactions involving personal aircraft sales and leases are tremendously complex and should only be implemented after careful consideration of all the applicable taxes, FAA regulations, and priority of title and liens. While the basic

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these seven states do not impose income tax, some of them impose other applicable taxes, including franchise taxes on business entities, excise taxes of aircraft, or Business and Occupation (B&O) tax on taxpayers engaging in business activities in the state which must be considered in the planning process.

<sup>73</sup> See WYO. STAT. ANN. §§ 39-13-101(a)(ii), 39-13-103 (2009).

<sup>74</sup> BARRON’S LAW DICTIONARY 471 (2d ed. 1984).

<sup>75</sup> I.R.C. § 164 (2006) (permitting a personal deduction from federal income taxes for state and local income taxes and taxes on real and personal property).

<sup>76</sup> See, e.g., WYO. STAT. ANN. § 34.1-9-311(a)(i) (2009) (indicating that the filing of a financing statement at the Wyoming Secretary of State does not perfect a security interest subject to federal law).

<sup>77</sup> See 49 U.S.C. §§ 40102, 44101–44112; see also 14 C.F.R. Parts 45, 47 and 49 (2008).

<sup>78</sup> Cape Town Implementation Act of 2004, Pub. L. No. 108-297, 118 Stat. 1095 (2004) (codified at 49 U.S.C. §§ 40101 note, 44107, 44108, 44113 (2006)).

<sup>79</sup> *Id.* The international registry is supervised by the International Civil Aviation Organization (ICAO) and is being operated out of Dublin, Ireland by Aviareto, a joint venture between SITA, an air transport IT service provider, and the Irish government. See Aviareto, <http://www.aviareto.aero/> (last visited Nov. 21, 2009).

sale of a personal aircraft from a broker to a purchaser in a state with no sales tax may initially seem appealing, tremendous pitfalls can occur with respect to use and income tax implications. Such a sale may also render hefty FAA penalties and fees.<sup>80</sup>

A better alternative to personal aircraft ownership comes in the form of a dry lease from a business entity lessor to business or individual lessees, which utilizes strategic states with aircraft tax-friendly implications.<sup>81</sup> Because the structuring of such a transaction requires meticulous understanding of various state income tax, sales and use taxes, and property tax implications, as well as a thorough understanding of FAA regulations in order to obtain the best possible outcome for the taxpayer, particular care should be taken to understand all such issues prior to implementation.

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<sup>80</sup> See *supra* notes 27–28 and accompanying text.

<sup>81</sup> See *supra* notes 29–70 and accompanying text.

APPENDIX I  
WESTERN STATE TAX MATRIX

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ARIZONA

<i>Sales/Use Tax Rate:</i> <sup>82</sup>	5.6% <sup>83</sup>
<i>Corporate Income Tax Rate:</i>	6.968% <sup>84</sup>
<i>Aircraft License and Registration Fees:</i>	\$5 registration fee + licensing fee equal to ½ % of FMV in lieu of personal property taxes <sup>85</sup>

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COLORADO

<i>Sales/Use Tax Rate:</i>	3.0% <sup>86</sup>
<i>Corporate Income Tax Rate:</i>	4.63% <sup>87</sup>
<i>Aircraft License and Registration Fees:</i>	None <sup>88</sup>

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IDAHO

<i>Sales/Use Tax Rate:</i>	6% <sup>89</sup>
<i>Corporate Income Tax Rate:</i>	7.6% <sup>90</sup>
<i>Aircraft License and Registration Fees:</i>	\$0.01 per pound not to exceed \$200 licensing fee <sup>91</sup>

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MONTANA

<i>Sales/Use Tax Rate:</i>	0% <sup>92</sup>
<i>Corporate Income Tax Rate:</i>	6.75% <sup>93</sup>
<i>Aircraft License and Registration Fees:</i>	Registration fee based on type and weight of aircraft in lieu of personal property taxes <sup>94</sup>

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UTAH

<i>Sales/Use Tax Rate:</i>	4.70% <sup>95</sup>
<i>Corporate Income Tax Rate:</i>	5% <sup>96</sup>
<i>Aircraft License and Registration Fees:</i>	\$25 registration fee + .4% (.004) of average wholesale market rate licensing fee <sup>97</sup>

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WASHINGTON

<i>Sales/Use Tax Rate:</i>	6.5% <sup>98</sup>
<i>Corporate Income Tax Rate:</i>	0%. B&O tax applies at various rates <sup>99</sup>
<i>Aircraft License and Registration Fees:</i>	\$15.00 registration fee + excise tax based on type of aircraft <sup>100</sup>

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WYOMING

<i>Sales/Use Tax Rate:</i>	4% <sup>101</sup>
<i>Corporate Income Tax Rate:</i>	0% <sup>102</sup>
<i>Aircraft License and Registration Fees:</i>	None <sup>103</sup>

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<sup>82</sup> State sales and use tax rates included in this matrix do not include applicable local city and county rates.

<sup>83</sup> ARIZ. REV. STAT. ANN. § 42-5010(A), (G) (2009).

<sup>84</sup> ARIZ. REV. STAT. ANN. § 43-1111 (2009).

<sup>85</sup> See ARIZ. REV. STAT. ANN. §§ 28-8324, -8325, -8335, -8336, -8342 (2009).

<sup>86</sup> COLO. REV. STAT. ANN. § 39-26-106(1)(a)(I) (West 2009).

<sup>87</sup> COLO. REV. STAT. ANN. § 39-22-301(I) (West 2009).

<sup>88</sup> See COLO. REV. STAT. ANN. §§ 41-1-101 to -108 (West 2009).

<sup>89</sup> IDAHO CODE ANN. § 63-3619 (2009).

<sup>90</sup> IDAHO CODE ANN. § 63-3025(1) (2009).

<sup>91</sup> IDAHO CODE ANN. § 21-114(b)(1) (2009).

<sup>92</sup> See MONT. CODE ANN. §§ 15-68-101 to -110 (2007).

<sup>93</sup> MONT. CODE ANN. §§ 15-31-121, -403 (2007).

<sup>94</sup> See MONT. CODE ANN. §§ 67-3-201; 67-3-206 (2007).

<sup>95</sup> UTAH CODE ANN. § 59-12-103(2) (2009).

<sup>96</sup> UTAH CODE ANN. § 59-7-104(2) (2009).

<sup>97</sup> UTAH CODE ANN. §§ 59-2-404(1)(b); 72-10-110(2)(a) (2009).

<sup>98</sup> WASH. REV. CODE ANN. § 82.08.020(1) (West 2009).

<sup>99</sup> See WASH. REV. CODE ANN. § 82.04.220 (West 2009).

<sup>100</sup> See WASH. REV. CODE ANN. §§ 47.68.250, 82.48.020(1), .030(1) (West 2009).

<sup>101</sup> WYO. STAT. ANN. § 39-15-104(a)-(b) (2009).

<sup>102</sup> WYO. STAT. ANN. § 39-12-101 (2009).

<sup>103</sup> See WYO. STAT. ANN. §§ 10-1-101 to 10-6-104 (2009).