

Aircraft Taxes:

TEXAS STATE AND LOCAL TAX ENFORCEMENT ON THE RISE

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As government budgets have tightened over recent years, the Texas Comptroller's Office and local property tax authorities appear to have stepped up sales, use, and property tax enforcement on aircraft. Aircraft transactions are good audit targets because they often involve large amounts of money and they are documented by an FAA paper trail. Experience shows that the Texas Comptroller's Office routinely receives transaction records from the FAA in order to monitor compliance with the Texas sales and use tax.

The transitory nature of aircraft make state and local taxation complicated. Aircraft owners should familiarize themselves with the tax impacts of a transaction before completing it. This article outlines some of the major Texas tax obligations for aircraft owners as well as exemptions that may mitigate the tax obligation. Keep in mind that tax exemptions are not favored under the law and qualification for an exemption is strictly construed against the taxpayer. The paper in a transaction trail matters dearly.

Texas Sales Tax

The Texas sales tax is 8 ¼% (at least in most metropolitan areas) of the sales price of an aircraft sold in Texas. The price is reduced by the value of a trade-in. The sales tax does not apply to a transaction where transfer of title and possession of the aircraft occur outside of Texas.

While the liability for the sales tax is ultimately borne by the buyer under the Texas Tax Code, the seller has a statutory collection responsibility and the Comptroller can audit either the buyer or the seller in any order to collect the tax. Sales contracts often allocate sales tax responsibility to the buyer, but the Comptroller is not bound such contractual provisions.

Certificated Carrier Exemption

Aircraft sold or leased to a licensed and certificated air carrier under Part 135 of the FAA Regulations and used exclusively to transport persons or property for hire in the regular course of business are exempt from sales and use tax. Aircraft to be used exclusively in FAA flight instruction are also exempt.

Purchase For Out-Of-State Use

If an aircraft is sold in Texas to an out-of-state buyer whose only use in Texas is to fly the aircraft out-of-state, then the buyer and the seller can avoid the application of the sales tax by completing an out of state exemption certificate (Texas Comptroller Form 01-907).

Occasional Sale Exemptions

Sometimes sales tax exemptions of general application prevent tax in an aircraft transaction. For example, a person who does not hold a sales tax permit and who is not in the business of selling tangible personal property can make up to two sales of tangible personal property in a rolling 12 month period tax free. This exemption does not apply if the buyer holds a sales tax permit, and it does not apply to leases. The occasional sale exemption can also exempt sales of aircraft in certain business reorganizations and bulk sale transactions.

Transfers Of Undivided Interests

One lesser known exemption applies to transfers of undivided interests in tangible personal property, if the following elements are satisfied:

- the purchaser must, either before or after the sale, own a joint or undivided interest in the tangible personal property with the seller;
- the seller must have paid sales tax on the tangible personal property when it was purchased;
- the sale must be made pursuant to the terms of a good faith contractual relationship between the seller and the purchaser, which means a legal relationship established between two or more persons created for considerations other than avoidance of the limited sales and use tax; and
- the exemption does not apply to sales between related corporations or other entities where the only joint ownership is the ultimate ownership of the entity's stock.

Sales For Resale

Aircraft purchased and held in inventory for resale are exempt. The Texas Comptroller, however, takes the position that a person or entity cannot purchase an aircraft for resale in Texas unless they hold a valid Texas resale certificate. Another limit on the sale for resale exemption is that if the buyer makes a divergent (i.e., personal) use of aircraft held in inventory, it will owe Texas use tax on the purchase price of the aircraft.

Texas Use Tax

The Texas use tax can best be understood as a complementary enforcement mechanism of the sales tax. In out-of-state sales where the seller is not required to collect Texas sales tax, the buyer is nevertheless required to pay Texas use tax if the buyer brings the aircraft back into Texas for use. The Comptroller rules provide that use tax will be due whenever an aircraft is used more than 50% of the time in Texas *or* if the aircraft is hangared in Texas. The factors the Comptroller considers to determine whether an aircraft is hangared in Texas include:

- whether the owner owns or leases hangar space in Texas;
- whether the aircraft is subject to local property taxes; and
- whether the owner represents to the FAA, an insurer, or any taxing authority that the aircraft is stored in Texas.

The exemptions that would apply under the Texas sales tax generally apply to use tax as well.

Local Property Tax

Property taxes are assessed on all income producing personal property located within a taxing jurisdiction on January 1 of each year. A temporary absence on January 1 will not avoid the application of the property tax. Hobby aircraft that are not used for business or commercial purposes are not subject to the property tax. The combined tax rates in most jurisdictions now exceed 2%, so the property tax is a major economic consideration for commercial and business aircraft owners.

Special Valuation For Business Aircraft

A “business aircraft” is an aircraft that is not a commercial aircraft, and is used for business purposes continually outside this state. The Texas Property Tax Code makes an interstate allocation of the fair market value of business aircraft using the following formula:

$$\text{FMV} \quad \times \quad \frac{\text{\# of Texas departures by the aircraft in prior calendar year}}{\text{total number of departures}} \quad = \quad \text{Property Tax Value}$$

Special Valuation For Commercial Aircraft

A commercial aircraft for Texas property tax purposes is an instrumentality of air commerce that is (1) primarily engaged in the transportation of cargo, passengers, or equipment for others for consideration; (2) economically employed when it is moving from point to point as a means of transportation; and (3) operated by a certificated air carrier.

The Texas Property Tax Code makes an interstate allocation of the fair market value of commercial aircraft using the following formula:

$$\text{FMV} \quad 1.5 \quad \times \quad \frac{\text{\# of Texas revenue departures in prior calendar year}}{8,760 \text{ (i.e., hours in a year)}} \quad = \quad \text{Property Tax Value}$$

Many appraisal districts are currently taking the position that more taxpayer friendly “commercial” formula only applies to “regularly scheduled” departures and is not available for Part 135 operators. The taxing authorities have taken this position in spite of the fact that a Part 135 certificate holder is a “certificated Air carrier” under FAA definitions.