

TAX MATTERS

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

Prepared and distributed by Aero & Marine Tax Professionals

Signing an out-of-state affidavit does not exempt you from filing a tax return for the purchase of your aircraft.

Many people sign affidavits when they purchase aircraft from a California retailer which allows them to make a purchase in a sales tax exempt manner. If you fit into this category, you probably have not been warned that subsequent to an audit of the retailer's records the Board of Equalization (Board) will audit your purchase directly with you.

The normal process used by the Board is to conduct audits of all aircraft retailers every three years. This means that even though the Board is aware you purchased the aircraft they may wait for several years to contact you. If you are feeling comfortable because the Board has not contacted you for the last several years, here is the danger in your current strategy.

The purchaser (you) has an obligation to file a tax return with the Board's Consumer Use Tax Section (CUTS) within one year of the purchase date (unless the Board contacts you in writing and establishes an earlier date). If you have been waiting for the Board to send you a bill, you were misled about the process. The purchaser has an obligation to file the return regardless of whether or not the Board contacts them. The reason the Board may have not contacted you immediately is that the seller was a retailer of aircraft.

When CUTS knows the seller is a retailer they will hold back your audit of the transaction until after they review the seller's audit. It is easier for them to send one auditor to the seller's location and review three years worth of sales files than to contact each buyer one-by-one. This creates the situation where they do not contact you right away. However, once they perform the audit of the retailer and discover your out-of-state delivery form which changes the transaction from a sales tax obligation to a use tax obligation, they will audit your transaction with you personally.

The following represents the process when you sign an affidavit and what your obligation is to the State of California:

A. If an out-of-state resident purchases an aircraft from a California retailer, and the retailer delivers said aircraft outside the State of California, there is no tax due to California if the following criteria are met:

You must meet the Board's definition of an out-of-state resident not the one you want to use. I have seen situations where the presence of a bank account, California driver's license, California property owned, or anything with any connection to California has turned the tide against the taxpayer.

The aircraft can not enter California for any reason within the first 90 days after the date of the out-of-state delivery. California Sales and Use Tax Regulation 1620.

B. If an out-of-state resident purchases an aircraft from a California retailer, and the retailer delivers said aircraft inside the State of California, there is no tax due to California if the following criteria are met:

See the notes in section A about residency.

The out-of-state resident must immediately remove the aircraft from California and the aircraft can not reenter California for any reason during the next twelve months. California Sales and Use Tax Regulation 1593. Maintenance flights are not exempted from the 12 month test.

C. If a California resident purchases an aircraft from a California retailer, and the retailer delivers said aircraft outside the State of California, there is no tax due to California if the following criteria are met:

The aircraft owner must be able to document and support one of the following criteria:

(1) The aircraft was used and stored outside California for a period of time exceeding 90 days from the date of transfer of title or possession. (note 1)

(2) If the aircraft entered California within the 90 day period, the aircraft must be used and stored outside California more than one-half the time during the year following the aircraft's date of first entry into California.

(3) If the aircraft entered California within the 90 day period, more than one-half of the flight time during the six months following the aircraft's date of first entry into California must be commercial (ie. business use) flight time traveled in interstate or foreign commerce. These flight hours can be all Part 91.

Additionally, if you have arranged for your aircraft to be owned by an out-of-state domiciled LLC or corporation and you smugly sit in your easy chair watching the news, comfortable that you are exempt, let me tell you a story.

A State of Washington-domiciled corporation purchased and leased aircraft that were used by various entities throughout the country. During the financing process a document was filed with the FAA that gave the California address of the primary shareholder who guaranteed the loans. The Board discovered the document and began to harass the shareholder as if he were the owner of the aircraft.

Some of the purchases of the leased aircraft were nearly seven years old and had been leased to a common carrier. By the time the Board contacted the taxpayer the Part 135 certificate holder had gone out of business and the records were gone. The shareholder was assessed tax on all the purchases. The assessments required the shareholder to file documents to support that each aircraft was used in an exempt manner in the State of California.

What is vital for you to understand is, there are two parts of every transaction. The substance and the form. The substance is the events as they actually occurred. The form is the documents to support all the events. If you remember nothing else from this article remember this:

The Board auditor was not with you when you made the purchase and was not with your aircraft while it was used during the test period where you are required to support your claim for an exemption. **All the auditor knows is what you reveal to him via your documentation.**

In other words, to an auditor the documents are the reality. It does not matter what you really did, it only matters what your documents say. Your testimony will be considered "self-serving." That means they will consider it irrelevant.

If you really believe your transaction is exempt, file the tax return. Don't wait for something to get lost. Be at cause over your claim for an exemption. Don't let the Board put you at effect.

If you are not sure, or if you are conservative and want to make sure it is exempt, send them to me for review. This will ensure that you are at cause over your claim for an exemption.

If you know it is taxable and spend your time praying you are not discovered, keep lighting candles. However, I have a suggestion for you. It came from an old baseball coach I knew. He always said, "when you find yourself at the bottom of a hole, STOP DIGGING."

I invite you to communicate with me, no matter which situation you think you are in.

-- Thomas A. Alston

(note 1) Effective October 1, 2004 the test period has been extended from 90 days to 12 months during the period of October 1, 2004 to June 30, 2007