

Nevada court ruling on use tax; Illinois court ruling on use tax as applied to fractional ownership



This month's issue of Aircraft Club Newsletter discusses a Nevada court ruling on application of use tax on the purchase of 4 aircraft by a taxpayer; and an Illinois court ruling on the application of use tax to fractional ownership of aircraft, both of which are noteworthy compliance issues.

Nevada state ruling

Cruising altitude

The Nevada Supreme Court recently ruled in *Harrah's Operating Company, Inc. v. Nevada Department of Taxation*, that an aircraft purchased by a taxpayer used in interstate commerce, is not subject to tax. In this case, where there is a statutory presumption against imposition of use tax on the purchase of aircraft used in interstate commerce, the State of Nevada failed to rebut such presumption, therefore, the

aircraft owner would be entitled to a refund of use taxes paid.

Stuck on the runway

After purchasing 4 business aircraft, Harrah's took delivery of 2 of those aircraft in Arkansas and flew those aircraft to Nevada on their first flights. For the other 2 aircraft, Harrah's took delivery in Oregon and those aircraft were first flown to Arkansas and California, respectively. The first flight of each aircraft carried passengers and carried passengers on the majority of each aircraft's subsequent flights.

The company paid Nevada use tax on the purchase of the 4 aircraft in the total amount of \$8.6 million, the company then sought a refund, claiming it was entitled to a presumption of non-taxability, which the Nevada Department of Taxation failed to overcome. Nevada imposes use tax on the in-state storage, use, or consumption of tangible personal property acquired outside the state; however, goods purchased outside of Nevada are presumed not to be purchased for use in Nevada, and thus not taxable under Nevada's use tax statute, if: (1) the first use of the goods occurs outside Nevada; and (2) the goods are continuously used in interstate commerce for 12 months.

The Nevada Supreme Court concluded that, for the 2 aircraft that were used for the carrying of passengers on their first flight between two points wholly outside of Nevada, the presumption applied to these aircraft (since the parties had stipulated that the second prong of the presumption was met (i.e., the goods are continuously used in interstate commerce for 12 months)), and were not subject to the use tax. With regard to the 2 aircraft that were flown within Nevada on their first flight, these 2 aircraft did not meet the first requirement of the *first use* occurring outside Nevada, and were held subject to the Nevada use tax.

The Nevada Supreme Court went on to state, within a footnote, that any expansion of Nevada's use tax must come from the Legislature, not the court.

Landing

If you have any questions in connection with the ruling or applicability to other states please call Rick Farley at (646) 471-4084 to discuss your questions in further detail.

Illinois circuit court holds fractional ownership of aircraft subject to use tax

Cruising altitude

Recently, the Illinois Circuit Court of Cook County ruled in *IPC Aviation, Inc. v. Illinois Department of Revenue*, that the acquisition of a fractional ownership interest in an aircraft by the taxpayer was subject to the Illinois use tax.

Stuck on the runway

In a case of first impression in Illinois, the taxpayer purchased an 18.75% fractional interest in an aircraft to be used primarily to transport business executives of its parent company, headquartered in Illinois. To participate in the fractional aircraft program, the taxpayer entered into many agreements, including a purchase agreement, joint ownership agreement, management agreement, and a dry lease agreement.

Under such agreements, generally, the taxpayer maintained the right to transfer or sell its interest in the aircraft. The agreements supported the taxpayer in taking its pro rata share of any depreciation, gain, loss, deduction, etc. for federal income tax purposes.

The taxpayer did not pay Illinois use tax in connection with the acquisition of the fractional interest in the aircraft; however, the Illinois Department of Revenue issued a notice of tax liability for the use tax along with penalties and interest.

To determine if the taxpayer's ownership interest was subject to use tax, the court needed to consider whether the taxpayer purchased tangible personal property at retail from a retailer and used such property in Illinois. The taxpayer argued that it purchased transportation services, which should not qualify as a purchase of ownership interest in

an item of tangible personal property. Based on the court's assessment of the substance of the transaction, however, the court noted that the taxpayer had rights or powers over the aircraft that were incident to the ownership of an aircraft.

The circuit court explained that Illinois law defines 'use' as the 'exercise by any person of any right or power over tangible personal property incident to the ownership of that property.' The court concluded that the tangible personal property, the fractional interest in the aircraft, was used by the taxpayer in Illinois since many flights of the aircraft (or substitute aircraft) were from or to Illinois creating substantial nexus between Illinois and the aircraft. Thus, the taxpayer was subject to the Illinois use tax.

Landing

If you have any questions in connection with the taxation of fractional ownership of aircraft, please call Rick Farley to discuss your questions in further detail.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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