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History Part III
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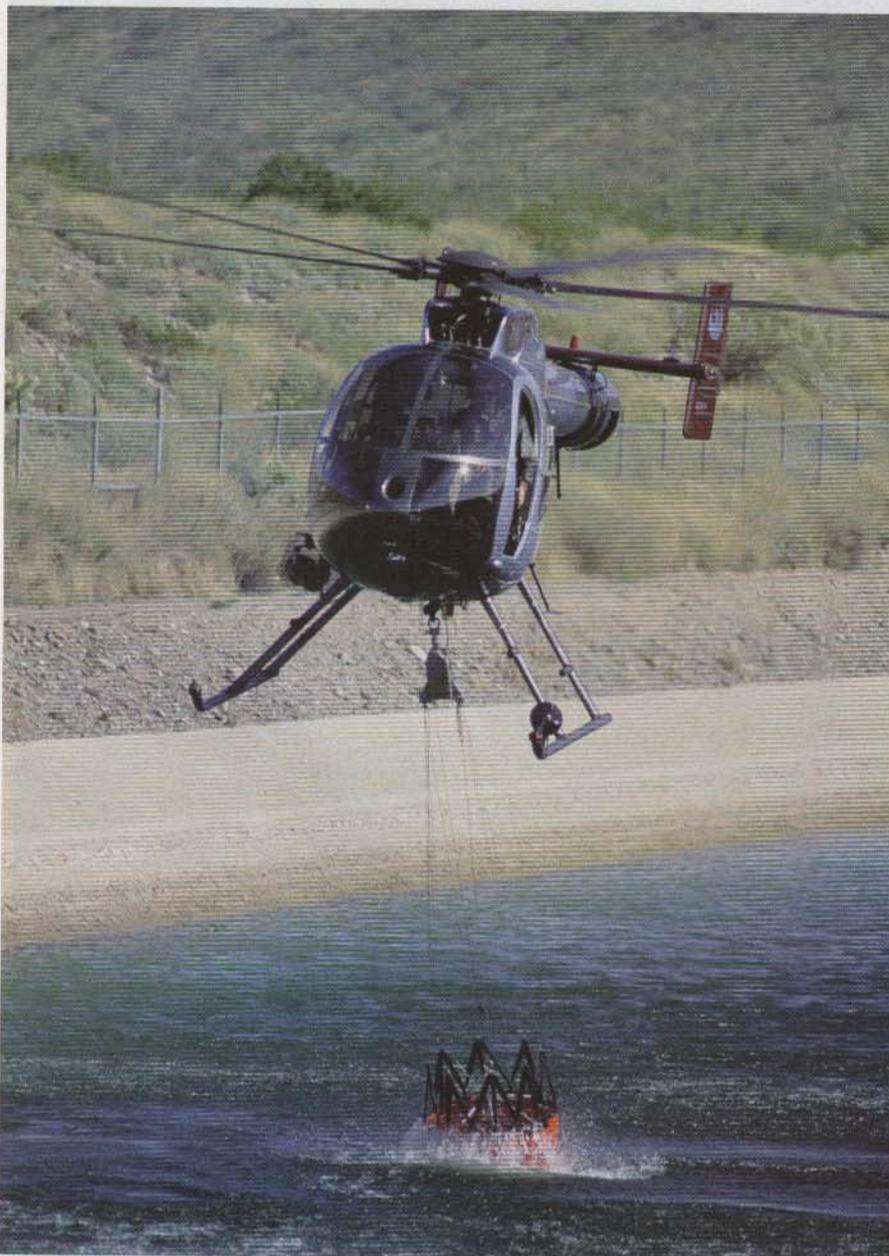
Features
2010 HAI Roundup

*The Taxability Of
Aircraft Equipment*

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CLEARING THE AIR ON THE TAXABILITY OF AIRCRAFT EQUIPMENT

By Brent A. Auberry



Many states tax personal property, but they exempt aircraft or subject aircraft to an excise tax in lieu of personal property. And equipment installed into aircraft may be exempt from a state's sales and use tax. But when is equipment taxable, and when does it escape tax? The answer is – it depends on the facts and the law at issue.

In Indiana, the State's property tax appeal agency recently ruled that assessors might not tax as personal property medical equipment that is affixed to and becomes part of a helicopter. In *Key Equipment Finance, Inc. v Vanderburgh County Assessor* (Oct. 19, 2009), the Indiana Board of Tax Review held that the interior of a medical evacuation helicopter retrofitted with equipment was a permanent part of the aircraft and was not taxable as personal property. Personal property is generally considered to include all types of machinery and equipment. The air transport company had stripped the Bell Helicopter's interior and retrofitted it to allow the treatment of patients in flight, including the addition of special flooring for patient stretchers, oxygen systems, medical pumps and monitors, as well as radios and satellite phones for communication with hospitals. All of the disputed medical equipment became a permanent part of the aircraft. Without it, the helicopter was no longer a medical aircraft. The Board concluded that the equipment was an integral part of the helicopter and was not separate, taxable personal property.

The Oregon Tax Court applied a similar

An MD520N practices refilling its bucket during a training exercise prior to the fire season. photo: MD Helicopters

TAXES

analysis in 1998 in *Thermal Graphics, Inc. v. Department of Revenue*, where it held that a camera installed on a Bell Helicopter used to fight forest fires became part of the aircraft and was not taxable personal property. The camera was designed and operated as part of a gimbal assembly mounted on the helicopter's airframe. Installation included electric power wiring so that the helicopter powered the assembly. The Department of Revenue contended that the camera was taxable because it was not a necessary part of the helicopter. But the Court found that the camera was permanently installed on the helicopter, even though it was removable. The Court reasoned that the camera was no different than any part of the aircraft that could be readily removed for service or adaption. The Court further noted that the camera was a "limited-function device" that could only be "used as part of or in conjunction with an aircraft." The camera had lost its identity as a separate piece of property and became part of the aircraft.

All engine parts are not necessarily engines. Engine parts were not engines exempt from sales tax, one California appellate court ruled in a 1979 decision, *National Aircraft Leasing, Ltd. v. State Board of Equalization*, where the state assessed sales tax on the parts and labor to modify engines on a Lockheed Hercules leased for use as a common carrier. The engines were removed from the aircraft, delivered to the repair facility, and reinstalled after modification. California assessed sales tax on the engine parts and labor charged for the modification. A statute exempted from sales tax the gross receipts from the sale of and the storage, use or other consumption in the state of aircraft leased for use as a common car-

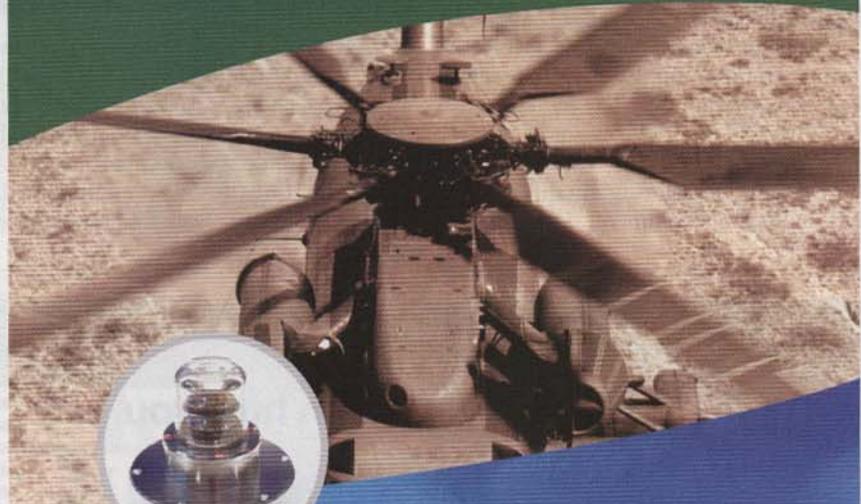
rier. The issue was whether the modification of the aircraft's engines was the sale, use or consumption of an aircraft. Prior court decisions, the court observed, determined that the term "aircraft" included "integral parts."

The Court in *National Aircraft Leasing* held the repair parts to be parts and not engines. The disputed taxable transaction

was not the sale of engines. It was the sale of repair parts and the related modification services. Even though the engines may at all times have remained integral parts of the aircraft, the Court explained that the same was not true with respect to the parts installed on those engines during the modification process. The parts

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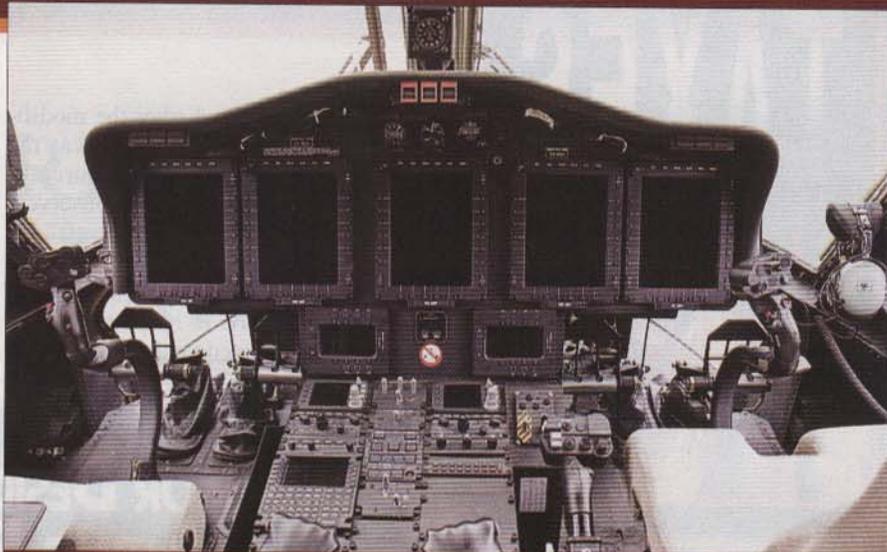
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were “disassociated” from the aircraft, only becoming integral to the aircraft at a later point in time. Under the prior cases cited, the parts likely would have been found exempt if they had been installed onto the engine out-of-state and then flown into California. But the exemption did not apply to aircraft parts sold in California that become integral parts of the aircraft only after installation.

Equipment can become part of an aircraft, as previously illustrated. But can an aircraft itself become equipment? Not in Texas, where facilities leased primarily to use for “aircraft equipment storage” are exempt from property tax. In a 2009 decision, *ICAN Enterprise, Inc. v. Williamson County Appraisal District*, the Court of Appeals of Texas held that leased aircraft hangers did not escape taxation under this exemption. The lessor argued that “aircraft” are “devices” or “vehicles” and that “devices” or “vehicles” are “equipment,” i.e. storing aircraft was the same as storing equipment. This string of



Cockpit of a Sikorsky S-92

photo: Patrick Allen

definitions was deemed too far-reaching. An “aircraft” can be “equipment” in the ordinary sense of the word without being “aircraft equipment.” By pairing the terms “aircraft” and “storage,” according to the Court, the legislature intentionally limited the type of equipment qualifying

for the exemption to equipment used to create aircraft or used in conjunction with aircraft to allow them to properly function. In essence, the Court held that the sum of all essential aircraft parts is less than the whole aircraft.

Sometimes the same equipment intended for the same use can be both taxable and non-taxable. In *State ex rel. Sunair Electronics, Inc.*, a 1965 Florida appellate court decision, the Comptroller of Florida assessed sales tax against high frequency radio equipment for use in light aircraft. The equipment was manufactured primarily for export to and use in foreign countries. The manufacturer delivered the equipment to foreign buyers either pre-installed or detached for later installment. The Court addressed these two scenarios separately. At issue was application of the Import-Export Clause of the United States Constitution, which prohibits states from imposing duties on exports. The pre-installed radio equipment never entered the stream of foreign commerce, the Court reasoned, because the equipment once installed lost its identity as a shipment of tangible personal property and became an integral part of the completed aircraft. The aircraft was not a finished product until after the equipment was fully installed. The sales tax was not a tax on the export of the equipment, because the equipment, as standalone equipment, never left the country.

The detached equipment, in contrast, was placed aboard the foreign purchaser’s aircraft for shipment. It was never physically attached to or made part of the aircraft before leaving the country. The lower court believed the detached equip-

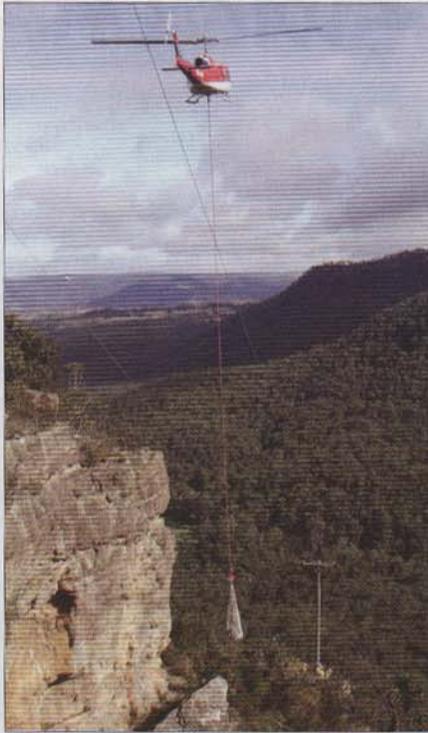
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ment was “constructively attached” to the aircraft and therefore subject to sales tax. But the appellate court explained that it could no more accept this argument than it would believe that a critically ill person could be “constructively dead.” The detached equipment, which entered the stream of foreign commerce once it was placed on the purchased aircraft at the manufacturer’s plant, was not taxable.

In this Florida decision, the same aircraft equipment intended for the same use by similar purchasers was treated differently by the same court because of whether it was affixed to the aircraft. Once installed, the equipment lost its independent identity and became part of the aircraft and was no different than the cooling, heating or radar systems for the aircraft. Sales tax applied because the state was taxing the equipment as equipment and not as an aircraft. The detached equipment was only equipment. The purchaser’s future intent to install the equipment did not matter. The court looked at



the status of the equipment at the time it was purported subject to tax, not the equipment’s theoretical or future status.

There are no bright line tests. Whether aircraft parts are taxable as personal property or subject to sales and use tax will depend on the nature of the part, if and how it is affixed to and used in the aircraft, whether it performs an essential aviation function, where it is affixed and used, as well as on the laws of the taxing jurisdiction and, as always, the motivations of the taxing officials. ■

Brent Auberry concentrates his practice in the area of state taxation. He has represented aircraft owners in dozens of sales and use tax appeals before the Indiana Department of Revenue and the Indiana Tax Court. Brent has also represented airport operators before the Indiana General Assembly regarding sales and use tax legislation affecting the leasing of aircraft.

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