Memorandum

105.0067

To: Mr. Scott Maxwell (MIC:37)
Consumer Use Tax Division

Date: August 16, 1995

From: John L. Waid
Tax Counsel

Subject: SPO UT XX-XXXXXX
Regulation 1593
Sale of Aircraft between Related Entities

I am responding to your memorandum to the Legal Division dated May 26, 1995. You state that the stock of taxpayer is owned by sole shareholder. The taxpayer purchased two aircraft from a related corporation (100% of the stock in each corporation was owned by the same person). The seller's use of the aircraft qualified it for the common carrier exemption provided by Regulation 1593(a)(1). The taxpayer applied for common carrier exemption status back in 1992, and was subsequently told that a reaudit would be necessary. The taxpayer's representative, Mr. E--- G---, questioned, in a letter received by the Consumer Use Tax Division on January 24, 1994, whether or not the aircraft must re-qualify for the exemption under the new owner since both the seller and buyer are related corporations. Ms. A--- C. P---, CPA, the taxpayer's successor representative, wrote again in a letter dated September 13, 1994, enclosed a copy of Mr. G---' letter, and stated the issue as follows:

> "At issue is whether aircraft need to be reaudited to verify common carrier status when there is a sale of aircraft between two sister corporations."

In his letter, Mr. G--- detailed another case in which he had been involved, in which his client was told that, because the transfer in that case was between related entities, there would be no new twelve-month testing period under Regulation 1593(b)(1), because there was no change in substantial ownership of the aircraft. In that case, his client acquired the aircraft in a gratuitous transfer and, although using the aircraft in a qualifying manner, remained subject to the disqualification from the exemption due to the previous owner's use. As a result, he proposed transferring the aircraft to one of his wholly owned corporations in order to restart the twelve-month testing period. At that time, the Consumer Use Tax Division determined that there would be no new testing period because the ultimate ownership of the aircraft was the same. Mr. G--- stated: "This is a substance over form approach."

OPINION

We agree with Mr. G---' position. A transfer of tangible personal property for a consideration between related entities is a sale under the Sales and Use Tax Law, and tax applies to that sale absent a statutory exemption. (Beatrice Corp. v. S.B.E. (1993) 6 Cal.4th 767.) When one party sells an aircraft to a related party, there are two possible exemptions which may protect the transaction from tax. First, the sale may qualify for the exemption provided by section 6281. If it does not, the sale is subject to tax unless the common carrier exemption provided by sections 6366 or 6366.1 apply.

This sale appears to be merely a transfer of the two planes from one corporation to another and seems not to be part of a transfer of substantially all of the seller's assets. Indeed, Mr. G--- is not trying to qualify for the exemption implemented by Regulation 1595(c). Therefore, we conclude that this transaction is a taxable sale of tangible personal property unless the purchaser's use qualifies for the common carrier exemption. Regulation 1593 states as follows:

"**(a) IN GENERAL -- DEFINITION.**

* * *

"The tax does not apply to the sale of and the storage, use, or other consumption of aircraft sold, leased, or sold to persons for the purpose of leasing, to:

"(1) persons using such aircraft as common carriers of persons or property under authority of the laws of this state, or the United States or any foreign government;

* * *

"(b) USE OF AIRCRAFT.

"(1) COMMON CARRIERS. In determining whether a purchaser or lessee of an aircraft is using that aircraft as a common carrier of persons or property, only that use of the aircraft by the carrier during the first 12 consecutive months commencing with the first operational use of the aircraft will be considered. If the purchaser does not own the aircraft for 12 consecutive months commencing with the first operational use, then only the period of time commencing with the first operational use that the purchaser owns the aircraft will be considered...."

The fact that the buyer and the seller are related corporations does not equate to their respective uses being the same. The regulation requires that we look at the first twelve consecutive months after the plane is put to its first operational use by the purchaser. Here, since there was a sale and purchase, we are required to examine the use of the aircraft by the purchasing corporation, not its predecessor. Therefore, we conclude that a new audit is required to determine if the purchasing corporation, though related to the selling corporation, uses the airplanes so as to qualify its purchase for the common carrier exemption.

There is apparently no dispute that the taxpayer's use of the two aircraft will likely qualify for the Regulation 1593 exemption; the taxpayer wants to avoid the expense of a re-audit. In the example Mr. G--- discusses, however, a reaudit might have made a difference. While we do not render an opinion as to the tax consequences of that transaction, we do suggest that Consumer Use Tax conduct a reaudit of that matter if not barred by the statute of limitations. His client's use still may not qualify for the common carrier exemption, but not merely because the substantial ownership is the same.

JLW:sr