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December 20, 1985

Mr. R. A. M---
Director – Taxes [M]
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Corporate Tax Dept. HXXX
P.O. Box XXX
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SY --- XX XXXXXX

Your letter to Mr. Donald J. Hennessy dated November 5, 1985, has been referred to the undersigned for reply. You ask whether California sales or use taxes would apply to aircraft engines under the following circumstances.

> "[D] Company ([D]) had contracted with a common carrier within the meaning of Section 6366 to build and deliver a new aircraft. Due to unforeseen and uncontrollable circumstances, the newly designed engines that were contracted to be installed on the aircraft were not available from the manufacturer. In order for [D] to meet its contractual obligation, it was proposed that upon delivery of the airframe, the customer would pay for the airframe and the not-yet-available engines. [D] would then lease to the customer, free of charge, another type of engine out of [D]'s inventory. This lease would continue until such time the newly designed engines were available (approximately 3 or 4 months). The leased engines would then be returned to [D]'s inventory after being zero-timed by the manufacturer."

You then describe three proposed methods by which the aircraft might be delivered to the customer. In all three methods, the "leased" engines would be installed in the aircraft in California prior to delivery of the aircraft to the customer.

"Leased" Engines

Given the facts as stated in your letter, it is our opinion that [D] will be loaning these engines and not leasing them. It is also our opinion that [D] will be liable for use tax on the engines, measured by the fair rental value of the engines for the term of the loan. Our reasons are as follows.

With certain exceptions not relevant here, Revenue and Taxation Code Sections 6094, subdivision (a), and 6244, subdivision (a), provide that use tax applies when tangible personal property is purchased without tax for resale but used prior to resale. Section 6009 of the Code defines "use" to include "the exercise of any right or power over tangible personal property incident to the ownership of that property ... except that it does not include the sale of that property in the regular course of business."

Section 6006, subdivision (g), with certain exceptions defines "sale" to include "[a]ny lease of tangible personal property in any manner or by any means whatsoever, for a consideration ...." In this case, since [D] will provide the "leased" engines for no consideration, the transaction will not qualify as a sale. Indeed, because of the lack of consideration, the transaction is in fact a loan and not a lease at all. We also note that aircraft engines are "mobile transportation equipment" under section 6023 of the Code, and a lease of mobile transportation equipment, even for a consideration, is not a sale under section 6006.

Since the loan of the engines is not a sale under section 6006, it is a use under section 6009. Therefore, unless otherwise exempt, use tax will apply under sections 6094 and 6244.

The exemptions authorized by sections 6366 and 6366.1, subdivision (a), for aircraft which are sold, leased or sold for leasing to certain persons, do not apply to the loaned engines. It is our position that aircraft engines do not qualify as aircraft for purposes of these exemptions. Even if engines were to be considered aircraft under some theory, the exemptions would not apply in this case because the engines are merely loaned and not sold, leased or sold for leasing.

For similar reasons, subdivision (b) of section 6366.1 is also inapplicable. That subdivision authorizes an exemption for "tangible personal property sold to an aircraft manufacturer and incorporated into aircraft to be leased by the manufacturer" to certain persons. In this case, while [D] is apparently the manufacturer of the aircraft, it will not be leasing the aircraft to its customer.

Finally, sections 6094, subdivision (b), and 6244, subdivision (b), provide that if the use of property "is limited to the loan of the property to customers as an accommodation while awaiting delivery of property purchased or leased from the lender ... the measure of tax is the fair rental value of the property for the duration or each loan so made." Under these sections, assuming that the use of the engines is limited to the accommodation loan, the tax on the engines will be measured by fair rental value. "Fair rental value" means the amount which [D] or other aircraft manufacturers would normally charge for a lease or similar engines.

Originally Contracted Engines

It is our opinion that the installation of the originally contracted engines will be a step in the manufacture or completion of the aircraft. (C.f. Sales & Use Tax Reg. 1593, subd. (d).) Accordingly, assuming that the aircraft sale qualifies for exemption under section 6366, the subsequent installation of these engines will not result in a California sales or use tax liability.

Very truly yours,

James E. Mahler
Tax Counsel

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