

**STATE BOARD OF EQUALIZATION**

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May 9, 1990

Mr. [A]
[S]
XXX --- ---, Eleventh Floor
--- ---, California XXXXX

Dear Mr. [A]:

This is in response to your letter dated April 2, 1990 regarding the application of sales and use tax to the use of aircraft engines in California. You state:

“P owns all of the issued and outstanding stock of S1 and S2. P is the manufacturer of certain aircraft engines and is based outside of California. It will sell or lease to S1 certain aircraft engines. Because S1 has no employees and no offices in the United States, and it is not practical for S1 to deal directly with U.S.-based aircraft operators, S1 in turn will sublease these engines to S2. S2 has employees in the U.S. who are available to arrange engine leases, administer engine lease contracts, collect lease payments and otherwise facilitate lease transactions.

“The sale or lease to S1 occurs outside of California. The engines are utilized in aircraft which are operated by common carriers of persons or property. The business activity of S1 is the leasing of engines which have been manufactured by P.

“Because the engines are held to satisfy emergency demand arising out of the unanticipated failure of one of the operator’s engines, the duration of a lease to any particular carrier is generally not intended to exceed one week or possibly two weeks, and it is not intended to occur with any great frequency.

“S1 will locate the engines at a major airport in California. When an operator, a common carrier, wishes to use one of the engines (typically, while performing maintenance or repair on another similar engine manufactured by P) and notifies S2 of such fact, S1 will lease such engine to S2, who in turn will lease the engine to the commercial operator. Most commercial operators will be engaged in flying, except for takeoff and landing, either in interstate or in foreign commerce.

Travel within the State of California is anticipated in only a limited number of cases. All of the commercial operators are based outside of the State of California.”

You believe that Revenue and Taxation Code section 6366.1 provides an exemption from sales or use tax for the sale or use of aircraft or component parts which are leased to lessees using the aircraft as common carriers and that under this provision the transactions about which you inquire are exempt from sales or use tax. We disagree. Subsection (a) of section 6366.1 provides an exemption with respect to the sale of a completed aircraft, which is the reason subsection (b) is necessary. That provision exempts sales of parts to a manufacturer which are incorporated into a completed aircraft which the manufacturer then leases under the conditions set forth in subsection (a). Section 6366.1 does not provide an exemption under the facts you present. This analysis is confirmed by subdivision (d) of Regulation 1593, a copy of which is enclosed. That provision clearly states that taxability of repair and replacement work on aircraft used by a common carrier depends on provisions of the Sales and Use Tax Law other than the common carrier exemptions. Below, we analyze the transactions about which you inquire under the applicable provisions.

The engines leased by S2 will be attached to aircraft and will presumably be functionally used only as part of those aircraft. Mobile transportation equipment (MTE) includes equipment such as aircraft as well as tangible personal property which becomes a component part of the aircraft. (Rev. & Tax. Code § 6023 (as opposed to 6366.1, this section specifically includes property becoming a component part of MTE).) Thus, the aircraft engines will constitute MTE.

The lease of MTE for use in transporting persons or property is not a sale for purposes of sales or use tax. (Rev. & Tax. Code § 6006(g)(4).) Rather, the sale of MTE for the purposes of leasing is the retail sale. If that sale is in California, it is subject to sales tax, or if the sale occurs outside California for use in California, it is subject to use tax measured by purchase price, unless the lessor makes a timely election to pay tax measured by fair rental value. (Rev. & Tax. Code §§ 6051, 6092.1, 6094(d), 6201, 6243.1, 6244(d).) When the lessor elects to pay use tax measured by fair rental value (generally the rentals payable), that tax must be paid whether the property is inside or outside this state. (Reg. 1661, a copy of which is enclosed.)

You state that P’s sale or lease occurs outside California. I assume you mean that P holds the engines outside California and transfers possession to S1 outside California. I also assume that the engines are first functionally used in California. They are therefore purchased outside California for use in California and use tax applies to that use. (Subd. (b)(3) of Reg. 1620, a copy of which is enclosed.) The measure of the use tax is purchase price unless, as discussed above, the purchaser makes a timely election to pay tax measured by fair rental value, whether the MTE is inside or outside California. (For purposes of this discussion, I assume that the sale price or rental charges between these related parties are set as if at arms length.)

When P leases an engine to S1, P owes use tax measured by its purchase price unless it reports use tax measured by fair rental value on its timely return for the quarter in which the MTE is

first leased to S1. When P sells an engine to S1, S1 owes use tax measured by its purchase price unless S1 reports use tax measured by fair rental value on its timely return for the quarter in which S1 first leases the MTE. I note that neither S1 nor S2 acquires the engines for resale (i.e., S1 for lease to S2 and S2 for lease to an operator) since a lease of MTE is never a sale. Rather, a person purchasing MTE for the purpose of leasing is the retail purchaser of the MTE. Sales or use tax applies to the sale to that person. It is only by virtue of the statutory provisions cited above that the lessor may elect to pay the lessor's use tax liability measured by fair rental value. The lessor may not avoid that use tax liability by taking a resale certificate from the lessee.

If you have further questions, feel free to write again.

Sincerely,

David H. Levine
Tax Counsel

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Enclosures