

PRIVATE TAXPAYER RULING LR01-003

January 10, 2001

The following private taxpayer ruling is in response to your request of August 8, 2000, as supplemented by your letters of October 12th and November 15th. Your letter requests a ruling regarding . . . and the application of transaction privilege tax on sales of aircraft to nonresidents of Arizona.

The following is a restatement of the facts presented in your letter.

Statement of Facts:

. . . and its affiliates are in the business of manufacturing and selling aircraft. . . . sells aircraft to either a single purchaser or sells a fractional percentage of ownership of an aircraft to as few as two and as many as 16 purchasers. In the latter case, the customers will purchase a percentage of interest in a pool of aircraft held for use by participants in the fractional share program.

. . .'s fractional ownership program allows customers to purchase undivided percentage interests in non-commercial aircraft to be used for pleasure or business purposes. The terms of the sale requires an obligation by the customer to enter into Management, Joint Ownership and Master Interchange Agreements. The Joint Ownership Agreement defines all of the interest percentage owners as tenants-in-common of the aircraft. The Management Agreement generally provides that . . . will provide management services for the aircraft including the inspection, maintenance, servicing and repair of the aircraft. In addition, the Management Company will facilitate access to alternate aircraft in the event the aircraft is unavailable for any reason as well as providing licensed pilots for the aircraft.

When . . . sells an aircraft to either a single or fractional owner, . . . takes title to and possession of "green" aircraft from either its parent corporation, . . ., a Canadian corporation, or from a U.S. affiliate (. . .) for resale to its customers. "Green" aircraft are aircraft which are capable of flight, being equipped with all necessary flight equipment, but whose interiors are not customized or completed with passenger seats, carpeting, etc. . . . will take possession of the aircraft in Canada or in the U.S. (possibly including Arizona) and transport the aircraft to a facility owned by an affiliate of . . ., in Arizona where the interior completion work is performed.

During the green stage, and possibly while the aircraft are located in the Arizona facility, . . . will transfer title of the aircraft to the customer, who is not a resident of Arizona and who does not intend to use the aircraft in Arizona. The execution of the contract for the transfer of title to the aircraft will occur outside of Arizona. The aircraft will remain at . . .'s facility in Arizona for a period of three to four months following the transfer of title to the customer for purposes of the completion of the interior of the aircraft. When the interior of the aircraft is complete, the customer will take delivery of the aircraft in Arizona and transport it to the customer's location outside of Arizona.

The standard purchase agreement provides that possession of the green aircraft or the aircraft, as applicable, shall remain with . . ., and . . . shall have the right to retain same until all amounts due from the buyer have been paid. At delivery time title to the completion work shall pass to the buyer free and clear of all encumbrances and risk of damage or loss of the completion work shall pass to the buyer. Pursuant to the payment schedule contained in the agreement, the final payment occurs at the date the customer takes delivery of the completed aircraft (the "delivery time").

Your Position:

The gross proceeds of sales or gross income derived from sales of aircraft, navigational and communication instruments and other accessories and related equipment sold to persons who are not residents of Arizona and who will not use the property in Arizona other than removing the property from the state are exempt from taxation and are deducted from the tax base.

The triggering event for the application of the Arizona transaction privilege tax is the occurrence of a "sale". Arizona defines a "sale" as "any transfer of title or possession, or both . . . in any manner or by any means whatever . . . for a consideration." While arguably, the transfer of title to the aircraft could be construed to be the "sale" for purposes of the application of the Arizona transaction privilege tax, given the facts and circumstances of the particular transaction, the sale does not occur for purposes of the Arizona transaction privilege tax until the transaction is complete, i.e., until the transfer of title and possession of the completed aircraft have occurred.

In the current scenario, the customer and . . . contemplate a sale and purchase of a *completed* aircraft. Therefore, in this situation, the prerequisites for a sale are both the transfer of title *and* possession of the aircraft, not merely the transfer of title. In fact, according to the terms of the purchase agreement, the final payment associated with the purchase of the aircraft occurs on the Delivery Date of the completed aircraft ("Delivery Time"). Furthermore, the purchase agreement provides that either party to the contract may terminate the Agreement before the Delivery Time upon the occurrence of certain events. This ability to terminate the agreement

further indicates that the sale is not complete until the "Delivery Time" – when the completed aircraft is delivered to the customer.

Moreover, the Arizona use tax, which compliments the transaction privilege tax, applies to a transaction where there is a "purchase". The term "purchase" is defined as "any transfer ... of tangible personal property for a consideration." This definition clearly contemplates a transfer of the subject property, which in the current scenario does not occur until the completed aircraft is delivered to the customer. Thus, the sale is not deemed to occur until delivery of the completed aircraft to the customer.

Accordingly, the exemption applies to the sale.

However, even if the sale was deemed to occur when the title to the green aircraft is transferred to the customer, the sale will be exempt from tax. In this event, the applicability of the transaction privilege tax to the proposed transaction would depend solely upon whether the presence of the aircraft in Arizona for the interior completion work constitutes a "use" by the customer in Arizona. The transaction privilege tax does not apply to the transaction if the nonresident purchaser will not *use* the property in Arizona other than removing the property from the state.

The Arizona statutes and regulations applicable to the transaction privilege tax do not contain a definition of the term "use". However, for purposes of the use tax (which compliments the transaction privilege tax), "use" is defined as "the exercise of any right or power over tangible personal property incidental to owning the property except holding for sale or selling the property in the regular course of business".

In *PCS, Inc. v. Arizona Dept. of Revenue*, 863 P.2d 920 (Ariz. 1993), the court addressed the interpretation of the term "use" and what activities constitute a "use" of property in the state. The case involved the application of use tax to the processing of tangible personal property in Arizona by the taxpayer. In determining whether the activities conducted by the taxpayer constituted a "use" of the property, the court looked to the statutory definition of the term "use" as well as the dictionary definition. The Random House Dictionary defined "use" as "to employ for some purpose; put into service; make use of".

Although the mere taking of title to the aircraft by . . . 's customer could constitute the exercise of a right or power over the property, the customer would not be considered to be *using* the aircraft while the interiors of the aircraft are being completed in Arizona under the dictionary definition of "use" as the customers do not take possession or otherwise employ the actual property for any purpose. The customer does not take possession or otherwise employ the property until the customer takes delivery of the aircraft upon the completion of the interior work.

In *PCS, Inc.* the court held that the taxpayer's activities constituted a "use" and the court distinguished the facts of PCS from the facts of a Wyoming case cited by the taxpayer. In *Exxon Corp. v. State Board of Equalization*, 783 P.2d 685 (Wyo. 1986), the issue was whether Exxon had used pipe in Colorado when it bought the pipe from a Texas vendor, had it shipped to Colorado where a coating of epoxy was put on to prepare it for installation and then shipped it to Wyoming where it was installed as part of a pipeline. The court said it looked to the nature of the property, its intended use, and whether the property had actually been used in Colorado. It concluded that the pipe's intended use was installation in the Wyoming pipeline and the activities in Colorado were merely preparatory for the pipe's ultimate intended use. Therefore the pipe was not "used" in Colorado. Throughout its journey the pipe remained pipe, its nature never changed and its intended use never changed.

You feel that . . .'s activities are similar to the taxpayer's activities in *Exxon Corp.* and distinguishable from the taxpayer's activities in *PCS, Inc.* The completion work which will be performed on the aircraft in Arizona is an activity which is merely preparatory for the aircraft's ultimate intended use. Throughout the time the aircraft is located in Arizona, neither its nature, nor its intended use will change. The aircraft will be capable of flight when it is brought into Arizona and this nature does not change. The only change is that the interior of the aircraft will be customized and completed with passenger seats, carpeting, etc.; cosmetic changes similar to those held not to constitute a use by the Wyoming court. Therefore, the aircraft will not be "used" in Arizona by the purchaser, except to remove the aircraft from Arizona.

Applicable Statutory Provisions:

Arizona Revised Statutes (A.R.S.) § 1-213 states:

Words and phrases shall be construed according to the common and approved use of the language. Technical words and phrases and

those which have acquired a peculiar and appropriate meaning in the law shall be construed according to such peculiar and appropriate meaning.

A.R.S. § 42-5001(13) defines "sale" as any transfer of title or possession, or both, of tangible personal property for a consideration.

A.R.S. § 42-5061 levies the transaction privilege tax on the business of selling tangible personal property at retail.

A.R.S. § 42-5061(B)(7)(c) provides a deduction from the tax base for aircraft, navigational and

communication instruments and other accessories and related equipment sold to persons who are not residents of this state and who will not use such property in this state other than in removing such property from this state.

A.R.S. § 42-5151(16) states:

"Use or consumption" means the exercise of any right or power over tangible personal property incidental to owning the property except holding for sale or selling the property in the regular course of business.

Discussion:

Arizona's transaction privilege tax is a tax on the privilege of conducting business in the State of Arizona. It is a tax on the seller, not on the purchaser. The seller may pass the burden of the tax on to the purchaser; however, the seller is ultimately liable to Arizona for the tax.

The transaction privilege tax is imposed on the business of selling tangible personal property at retail. The term "sale" includes any transfer of title or possession, or both, of tangible personal property for a consideration. [A.R.S. § 42-5001(13)]

When . . . transfers title of the green aircraft to the purchaser, a sale has occurred. However, a deduction from the tax base is provided for aircraft, navigational and communication instruments and other accessories and related equipment sold to persons who are not residents of this state and who will not use such property in this state other than in removing such property from this state. [A.R.S. § 42-5061(B)(7)(c)]

The transaction privilege tax statutes do not define the term "use". For purposes of the use tax, the term "use" means the exercise of any right or power over tangible personal property incidental to owning the property. [A.R.S. § 42-5151(16)]

However, words and phrases that have acquired a peculiar and appropriate meaning in the law shall be construed according to such peculiar and appropriate meaning. Otherwise, words and phrases shall be construed according to the common and approved use of the language. [A.R.S. § 1-213]

The definition of "use" that is provided by statute is for the unique purpose of the use tax and does not transcend other areas of the law. For purposes of the transaction privilege tax, the

term "use" shall be construed according to the ordinary meaning of the word. When used in the context of the exemption statute, the term "use" means "to put into action or service; employ". *Webster's Third New International Dictionary* (Unabridged, 1993).

When a purchaser obtains title to green aircraft the purchaser is not "using" the aircraft in this state when the aircraft is retained in this state, at the direction of the seller, for the sole purpose of completing the manufacturing process.

Conclusion and Ruling:

The department rules that the income derived by . . . from sales of aircraft, to either single purchasers or fractional share purchasers, is not subject to transaction privilege tax when such purchasers are not residents of Arizona and the purchasers will not use the aircraft in Arizona other than in removing the aircraft from this state.

The department further rules that when a purchaser obtains title to partially manufactured aircraft, the purchaser is not "using" the aircraft in this state when the aircraft is retained in this state, at the direction of the seller, for the sole purpose of completing the manufacturing process.

The conclusions in this private taxpayer ruling do not extend beyond the facts as presented in the request for a private taxpayer ruling dated August 8, 2000, and supplemented by your letters of October 12th and November 15th.

This response is a private taxpayer ruling and the determination herein is based solely on the facts provided in your request. The determination in this taxpayer ruling is the present position of the department. This determination is subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different department position.

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