New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-05(13)S
Sales Tax
April 27, 2005

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. S031021A

On October 21, 2003, the Department of Taxation and Finance received a Petition for Advisory Opinion from Ernst & Young, LLP, 830 Bausch & Lomb Place, Rochester, New York, 14604. Petitioner, Ernst & Young, LLP, submitted additional information pertaining to the Petition on January 14, 2005.

The issues raised by Petitioner are:

1. Whether charges paid for leasing an aircraft are subject to New York sales and use tax.

2. Whether charges for transportation services are subject to New York sales and use tax.

3. Whether maintenance costs and related equipment purchases in connection with the use of the aircraft are subject to New York sales and use tax.

4. Whether the merger of related companies, one of which had been engaged in the provision of transportation services, affects the application of New York sales and use tax to the merged company's transportation property.

5. Whether the provision of transportation services to a third party will affect the purchased property's eligibility for "commercial aircraft" exemptions.

Petitioner submitted the following facts as the basis for this Advisory Opinion.

XYZ Company, Inc. ("XYZ") is a corporation wholly owned by Company A. XYZ has leased an aircraft ("A1") since 1999. New York State sales tax was paid at the inception of the lease on the total of lease payments due for the lease of A1. Prior to July 2002, all of XYZ's expenses were paid by Company A, and XYZ provided air travel services for Company A and its related companies at no charge.

In 2002, Company A started to investigate the potential purchase or lease of a second aircraft for use in its business. Such aircraft was also to be acquired by XYZ. Thereafter, in anticipation of acquiring a second aircraft ("A2"), XYZ and Company A formalized, by contract, the arrangement regarding XYZ's aircraft services in the following manner:

- XYZ and Company A entered into a transportation services agreement under which XYZ agreed to provide air transportation services to Company A for a fee. This fee will be in an amount that covers all direct and indirect operating costs of A1 and A2.

- Although other companies related to XYZ and Company A may use the aircraft, XYZ will not separately contract for air transportation services with any of these companies. Instead, Company A will be XYZ's only customer. Company A will pay all charges for use of A1 and A2. Company A will not pass any charges through to its related companies for their use of either aircraft; all charges will be borne exclusively by Company A.

- XYZ will not be certified as an air carrier under Part 135 of the Federal Aviation Regulations, but will operate its aircraft under Part 91 of the Federal Aviation Regulations.

- XYZ will employ and provide licensed pilots as well as continual pilot training, pilot medical examinations and uniforms.

- XYZ will retain possession and control of the airplane during the term of the lease and the transportation service agreement.

- XYZ will maintain the right to hire and fire the pilots.

- XYZ will use its discretion in performing the air transportation services and will select the routes to be taken.

- XYZ will be responsible for scheduling the use of the aircraft.

- XYZ will directly pay all operating expenses, including wages, insurance, fuel, hangar and general storage fees, weather services, etc.

- XYZ will arrange for the aircraft to be inspected, maintained, serviced, repaired, overhauled, and tested in accordance with approved Federal Aviation Administration ("FAA") standards and guidelines.

- XYZ will keep all records, logs, and other materials required by FAA to be maintained with respect to the aircraft.

- During periods the aircraft are not being utilized to provide air transportation service to Company A, its related companies and employees, XYZ will retain the right to use the aircraft and to retain any money it earns in the use of the aircraft.

- XYZ will have some officers and directors that are not also officers and directors of Company A. XYZ will hold separate board meetings with minutes taken.

- XYZ is a separate legal entity and will maintain its own books and records, as well as its own checking account in order to pay operating expenses.

- XYZ will hire its own employees which are distinct from Company A's employees.

- None of the related companies holds an ownership interest in the aircraft.

- XYZ will have separate space that it rents for its operations.

- If XYZ uses any of Company A's services or property, it will pay fair market value for these items.

In June 2002, XYZ contracted for the lease of another plane ("A2"). No New York sales tax was paid on this lease.

Early in 2003, XYZ was merged into MNO Company, Inc. ("MNO"), another wholly owned subsidiary of Company A. MNO, as a common paymaster, provides payroll services for Company A as well as for all management personnel of Corporation A's subsidiaries. Company A has 60 subsidiaries which have 700 employees working in approximately 100 locations across the United States.

The previously referenced transportation services agreement that covered the transportation services provided by XYZ to Company A remained in full force and effect between MNO and Company A. There were no changes to this arrangement as a result of the merger of XYZ into MNO. Therefore, the above statement of facts applies equally to MNO as of the date of the merger of XYZ and MNO.

On occasion, XYZ would, and MNO currently does, provide air transportation services for 123 Company, Inc. ("123"), an entity outside the affiliated group of Company A. XYZ did not, and MNO does not, have a contract or formalized agreement with 123. XYZ was, and MNO is, compensated by Company A for the air transportation services provided for 123 which, as a non-affiliated entity, is considered by the parties to be a guest of Company A. The use of the aircraft in providing services for 123 did, and continues to, amount to considerably less than 50% (less than 10% on average) of the total amount of operational time for A1 and A2 during any given month.

Applicable law and regulations

Section 1101(b) of the Tax Law provides, in part:

When used in this article for the purposes of the taxes imposed by subdivisions (a), (b), (c) and (d) of section eleven hundred five and by section eleven hundred ten, the following terms shall mean:

* * *

(4) Retail sale. (i) A sale of tangible personal property to any person for any purpose, other than (A) for resale as such or as a physical component part of tangible personal property, or (B) for use by that person in performing the services subject to tax under paragraphs (1), (2), (3), (5), (7) and (8) of subdivision (c) of section eleven hundred five where the property so sold becomes a physical component part of the property upon which the services are performed or where the property so sold is later actually transferred to the purchaser of the service in conjunction with the performance of the service subject to tax. . . .

* * *

(iv) The term retail sale does not include:

(A) The transfer of tangible personal property to a corporation, solely in consideration for the issuance of its stock, pursuant to a merger or consolidation effected under the law of New York or any other jurisdiction.

* * *

(17) Commercial aircraft. Aircraft used primarily (i) to transport persons or property, for hire, (ii) by the purchaser of the aircraft primarily to transport such person's tangible personal property in the conduct of such person's business, or (iii) for both such purposes.

Section 1105(a) of the Tax Law imposes sales tax on the receipts from every retail sale of tangible personal property, except as otherwise provided.

Section 1105(c) of the Tax Law imposes sales tax on the receipts from every sale, except for resale, of the following services:

* * *

(3) Installing tangible personal property . . . or *maintaining, servicing or repairing tangible personal property* . . . not held for sale in the regular course of business . . . whether or not any tangible personal property is transferred in conjunction therewith, except:

* * *

> *(v) such services rendered with respect to commercial aircraft, machinery or equipment and property used by or purchased for the use of such aircraft* as such aircraft, machinery or equipment, and property are specified in paragraph twenty-one of subdivision (a) of section eleven hundred fifteen of this article; . . . (Emphasis added)

Section 1111(i) of the Tax Law provides, in pertinent part:

> (A) Notwithstanding any contrary provisions of this article or other law, with respect to any lease for a term of one year or more of . . . noncommercial aircraft having a seating capacity of less than twenty passengers and a maximum payload capacity of less than six thousand pounds, or an option to renew such a lease or a similar contractual provision, all receipts due or consideration given or contracted to be given for such property under and for the entire period of such lease, option to renew or similar provision, or combination of them, shall be deemed to have been paid or given and shall be subject to tax, and any such tax due shall be collected, as of the date of first payment under such lease, option to renew or similar provision, or combination of them . . . For purposes of this subdivision, (1) a lease for a term of one year or more shall include any lease for a shorter term which includes an option to renew or other like provision (or more than one of such option or other provision) where the cumulative period that the lease, with or without such option or provision, may be in effect upon exercise of such option or provision is one year or more and (2) receipts due and consideration given or contracted to be given under any such lease or other provision for excess mileage charges shall be subject to tax as and when paid or due.

Section 1115(a)(21) of the Tax Law exempts commercial aircraft from the sales tax imposed by section 1105(a) of the Tax Law and from the compensating use tax imposed under section 1110, as follows:

> *Commercial aircraft primarily engaged in intrastate, interstate or foreign commerce,* machinery or equipment to be installed on such aircraft and property used by or purchased for the use of such aircraft for maintenance and repairs and flight simulators purchased by commercial airlines. (Emphasis added)

Section 1115(dd) of the Tax Law exempts services to aircraft from the sales tax imposed by section 1105(a) of the Tax Law and from the compensating use tax imposed under section 1110, as follows:

> (1) Services otherwise taxable under paragraph three of subdivision (c) of section eleven hundred five or under section eleven hundred ten of this article, and tangible personal property purchased and used by the person who sells such services in performing such services, where such property becomes a physical component part of the property upon which the services are performed or where such property is a lubricant

applied to aircraft, shall be exempt from tax under this article where such services are performed on aircraft.

(2) The service of storing an aircraft provided by a person who sells a service exempt under paragraph one of this subdivision, when such storing is rendered in conjunction with, and during the rendering of, such service to such aircraft, shall be exempt from the tax imposed under paragraph four of subdivision (c) of section eleven hundred five of this article.

Section 526.6(d) of the Sales and Use Tax Regulations provides, in part:

Exclusions relating to corporate and partnership transactions. (1) The following transfers of property are not retail sales:

(i) The transfer of property to a corporation, solely in consideration for the issuance of its stock, pursuant to a merger or consolidation effected under the law of New York or any other jurisdiction.

* * *

(6) Mergers and consolidations. (i) A merger under the law of New York is the procedure whereby two or more corporations merge into a single corporation which is one of the participating corporations.

(ii) A consolidation under the law of New York is the procedure whereby two or more corporations consolidate into a single corporation which is a newly organized corporation.

(iii) A merger or consolidation under the law of any other jurisdiction is one that qualifies under section 368(a)(1)(A) of the Internal Revenue Code or which meets the requirements of the law of the State, District of Columbia or territory pursuant to which it was effected.

Example 6: Corporation A is merged into Corporation B.

* * *

(iv) Where a corporation purchases another corporation's assets in consideration of issuance of stock of the purchasing corporation, or the parent of the purchasing corporation, such as under section 368(a) (1) (C) of the Internal Revenue Code, the transaction does not qualify as a merger or consolidation, even if the selling corporation is subsequently liquidated.

Example 9: Corporation A will transfer its assets to Corporation B in consideration for B's issuance of shares of its stock. Corporation A will continue to exist for discharging its expenses, and then will be dissolved. The transfer of tangible personal property will be subject to tax, as it is carried out under a plan of reorganization but is not a statutory merger or consolidation.

Technical Services Memorandum, entitled *Tax Law Defines Commercial Vessels and Commercial Aircraft*, November 7, 1996, TSB-M-96(14)S, states, in part:

Statutory changes in the definitions of commercial vessels and commercial aircraft have expanded the current sales and use tax exemptions for commercial vessels and aircraft, effective December 1, 1996. The expanded exemptions now also include vessels and aircraft that transport, in qualifying commerce, tangible personal property in the conduct of the business of the purchaser of the vessels or aircraft. (Purchaser includes, for example, a buyer, renter or lessee of the vessel or aircraft.) The exemption covers certain purchases of tangible personal property necessary to operate the exempt vessels and aircraft, and also exempts maintenance and repair services to the exempt vessels or aircraft, and fuel used by the exempt vessels and aircraft.

Previously, only vessels and aircraft used by the purchaser primarily (at least 50% of the time) in the transportation for hire of other persons or their property qualified for the exemption. Thus, self-use of a vessel or aircraft to transport one's own property was not a qualifying use.

* * *

Commercial Aircraft

The expanded definition of a commercial aircraft is an aircraft used primarily:

- to transport persons or property, for hire;
- by the purchaser of the aircraft primarily to transport the purchaser's own tangible personal property in the conduct of the purchaser's business; or
- for both of the above purposes.

To be exempt, a commercial aircraft must be primarily engaged in intrastate, interstate or foreign commerce. . . .

In addition to the exemption applicable to the aircraft, the exemption also applies to:

- machinery and equipment installed on the aircraft;

- property used by or purchased for the use of the aircraft for maintenance and repairs;

- *the services of maintaining, servicing and repairing the aircraft, machinery or equipment installed on the aircraft, and property used by or purchased for the use of the aircraft*; (Emphasis added)

- flight simulators purchased by commercial airlines.

Permanent air cargo containers suitable for repeated use, and specifically designed to facilitate the carriage of goods on aircraft, are exempt from New York State sales and use taxes. Repairs to air cargo containers are likewise exempt.

For more information about the exemptions granted to commercial aircraft primarily engaged in intrastate, interstate or foreign commerce, see TSB-M-80(4)S, *Exemptions For Commercial Aircraft,* and TSB-M-80(4.1)S, *Air Cargo Containers*. In reading TSB-M-80(4)S, please read-in the expanded definition of a commercial aircraft . . . and also substitute 50% for the out-of-date 75% threshold for determining when a commercial aircraft is primarily used in the qualifying commerce.

Opinion

In 2002, XYZ and Company A formalized the arrangement for XYZ's aircraft services. Essentially, XYZ was contracted to provide air transportation services to Company A for a fee. Pursuant to its service agreement with Company A, XYZ will provide air transportation services to officers and employees of Company A and guests of Company A, whether such guests be employees and officers of Company A's affiliates or others (e.g., 123 Company, Inc.). Company A will pay all charges related to the transport of these passengers. Early in 2003, XYZ was merged into MNO. The transportation agreement for services provided by XYZ to Company A remains in full force and effect between MNO and Company A.

On occasion, XYZ would, and MNO currently does, provide air transportation services for 123 which is not an affiliate of Company A. XYZ was, and MNO is, compensated by Company A for the air transportation services provided for 123. On average, the transportation services provided for 123 amount to less than 10% of the total amount of operational time for A1 and A2 during any given month.

The taxability of XYZ's and MNO's leases of A1 and A2 depends upon whether the aircraft qualify as commercial aircraft as defined by section 1101(b)(17) of the Tax Law. If over 50% of an aircraft's use is devoted to transporting customers for compensation, and the compensation reasonably reflects the cost of operating the aircraft, such aircraft may qualify as a

commercial aircraft primarily engaged in intrastate, interstate or foreign commerce for purposes of section 1115(a)(21) of the Tax Law. (See *Pasquale & Bowers*, Adv Op Comm T & F, August 1, 1996, TSB-A-96(49)S; *CB Applications, LLC*, Adv Op Comm T&F, February 1, 2000, TSB -A-00(6)S; *Philip Morris Management Corp*, Adv Op Comm T&F, October 11, 2000, TSB-A-00(38)S.)

Since XYZ did retain, and MNO similarly retains, complete dominion and control over the operations and maintenance of the aircraft, XYZ's charges to Company A were, and MNO's charges to Company A are, for the provision of transportation services and are not considered to be charges to Company A for the rental, lease or license to use such aircraft. Such transportation services are not included among the enumerated services taxable under section 1105 of the Tax Law, and charges for such transportation services are not subject to sales tax.

The fact that transportation services are provided to a single customer does not disqualify either XYZ or MNO for the commercial aircraft exemption provided by section 1115(a)(21) of the Tax Law. See *John J. Bischoff*, Adv Op Comm T&F, April 8, 1999, TSB-A-99(20)S. Thus, assuming more than 50% of A2's use is to provide air transportation services for hire to Company A, the lease of A2 to XYZ, and subsequently to MNO as successor to XYZ, would qualify for the exemption provided by section 1115(a)(21) for commercial aircraft. The merger of XYZ into MNO does not affect the application of this exemption to the aircraft. A properly completed *Exempt Use Certificate*, Form ST-121, should be provided to the lessor of the aircraft. (See *Pasquale & Bowers, supra*; *CB Applications, LLC, supra*; *Philip Morris Management Corp, supra*.)

Neither XYZ nor MNO is entitled to a refund of sales tax paid on the initial lease of A1. When XYZ leased A1 in 1999, the aircraft did not qualify for exemption as a commercial aircraft under section 1115(a)(21) of the Tax Law since it was not used to provide air transportation services to Company A for hire. Since the initial lease of A1 was for a term of one year or more, sales tax was due on the total amount of the lease payments for the entire lease term at the time the first lease payment was made, provided that A1 has a seating capacity of less than 20 passengers and a maximum payload capacity of less than 6,000 pounds. See section 1111(i) of the Tax Law. The taxable status of the lease transaction is determined at the time of such first lease payment. However, any new lease of A1 subsequently executed, or subsequent exercise of an option to purchase A1 by MNO, can qualify for the exemption provided by section 1115(a)(21) for commercial aircraft, if the statutory requirements for exemption are met.

Current maintenance costs in connection with the use of A1 and A2 by MNO qualify for exclusion from tax under section 1105(c)(3)(v) of the Tax Law. Current purchases by MNO of machinery or equipment to be installed on the aircraft, and of property to be used for the maintenance and repair of the aircraft, are exempt under section 1115(a)(21) of the Tax Law. See *Federal Express Corporation*, Adv Op Comm T&F, December 26, 1996, TSB-A-96(81)S; *KPMG LLP*, Adv Op Comm T&F, March 25, 2003, TSB-A-03(12)S.

The transfer of tangible personal property to a corporation solely in consideration for the issuance of its stock is not a retail sale subject to tax, if such transfer is pursuant to a merger or consolidation effected under the laws of New York or any other jurisdiction. See section 1101(b)(4)(iv)(A) of the Tax Law and section 526.6(d)(1)(i) and (6) of the Sales and Use Tax Regulations. Assuming the merger of XYZ into MNO was such a qualifying merger, the transfer of assets from XYZ to MNO solely in consideration for MNO's stock would not have been subject to sales tax.

The use of the aircraft to provide transportation services for the unaffiliated entity, 123, less than 10% of the total operational time for the aircraft does not affect the eligibility of the aircraft for the exemption under section 1115(a)(21) of the Tax Law. Since XYZ was, and MNO is, compensated by Company A for providing transportation services for 123, the aircraft is considered to be used for hire when providing such services for 123.

The above analysis presumes treatment of XYZ, MNO, Company A and related companies as separate legal entities. However, if the activities of XYZ, MNO, Company A or their related companies are so dominated and controlled by the parent or each other, or their activities were so commingled, that they would be considered to be operating as alter egos of each other rather than separate legal entities, then the corporate structures would be disregarded and the conclusions reached in this opinion would not apply. See *Harfred Operating Corporation*, Adv Op St Tx Comm, July 18, 1986, TSB-A-86(28)S. If the related entities in the present case should be disregarded as separate legal entities for purposes of sales tax, the aircraft would not be considered to be commercial aircraft but rather property purchased for self use by the related entities. Under such circumstances, the purchases by XYZ or MNO of the aircraft, and equipment and maintenance supplies for the aircraft would not qualify for the commercial aircraft exemption. However, purchases of repair and maintenance services performed on such aircraft by third party service providers would be exempt from tax pursuant to the provisions of section 1115(dd) of the Tax Law.

DATED: April 27, 2005

/s/
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.