

# Confusing “Use Tax” Exemption Requirement: “First Functional Use” Explained

By: Aero-tax Compliance Experts, LLC

The article written last month titled “Proper Delivery Outside of California Begins the “Use Tax” Exemption Process” explained the importance of, and how to, properly take delivery of an aircraft outside the state, which is the first step in the California sales and use tax exemption process. If you didn’t get a chance to read that article you can contact Aero-tax Compliance Experts, LLC (ACE) for a copy or visit [www.aero-tax.com](http://www.aero-tax.com). This article is also available right here at [www.121five.com](http://www.121five.com), under the Features tab: **CA Use Tax: Minimize it Through Planning**.

Many aircraft owners and potential owners have contacted us for an explanation on California’s “first functional use” requirement. We have learned that there is a lot of mis-information and confusion on this issue. Our attempt is to clarify some of the confusion that exists and eliminate the mis-information with the “first functional use” requirement for the California use tax exemption process.

“First functional use” is a critical component of the California use tax exemption process. California Sales and Use Tax Regulation 1620 defines first functional use as “use for which the property was designed.” An aircraft is defined in Law section 6274 as “any contrivance designed for powered navigation in the air except a rocket or missile.” Logically, one would conclude that first functional use of an aircraft is flight because aircraft are designed to fly; right? Not necessarily. In my experience with the sales and use tax law, one can not rely upon logic.

The California State Board of Equalization (BOE) has effectively confused the term “for which the property was designed” with “how big it is,” or “how is it configured.” I’ll explain; in May of 2002 a staff member of the BOE’s tax counsel (writer) drafted a memorandum to another staff member explaining to them the writer’s interpretation of first functional use. Somehow, the writer deduced a formula, or justification, to distinguish between aircraft designed for personal purposes and aircraft designed for commercial purposes. Simply put, the writer concluded in the memorandum that an aircraft with 6 or fewer seats was an aircraft designed for personal purposes, and an aircraft with 7 or more seats was designed for commercial purposes.

To confuse the issue even further, the writer decided that all jet aircraft were designed for commercial purposes, and “personal” aircraft could be “configured” for commercial purposes. Additionally, the writer added that it was possible for someone to justify a large jet as a personal use aircraft.

Now that the writer made a distinction between personal and commercial aircraft, the writer defined the “first functional use” for each. Aircraft that are designed for personal purposes were first functionally used when flown, and aircraft designed for commercial purposes were first functionally used when flown with a passenger or cargo onboard.

We have researched and reviewed several thousand legal opinions and rulings from the BOE on this issue. The BOE had interpreted first functional use as flight, up until this memorandum was drafted and distributed throughout the agency. After the distribution its effect was immediate, and in some cases a retroactive application of the new formula. During our research, we developed the industries most successful approach to complete the first functional use requirements pursuant to the current standards, and have projected other items that may be required in the future.

As a standard practice, Aero-tax advises that the purchaser bring someone, to the out of state delivery location, to act as a true passenger (not a pilot, co-pilot, flight crew, CFI, etc.) onboard a flight (or two) outside of California before proceeding with their specific exemption. In addition, this flight must

begin in one state, country, territory, etc. (not California), and end in a separate state, country, territory, etc. (not California). For example, this flight may depart from the out of state delivery location (Oregon), to another state (not within California or Oregon). Depending on the “design/size” of the aircraft and for those who are claiming the commercial interstate or foreign commerce exemption, they must conduct business at the location they travel to. In addition, documentation must be obtained to support the business purpose (i.e., meeting notes, invoices, proposals, etc.) of the flight.

After the first functional use flight has been made, and prior to departing that location, fuel must be purchased, ideally using a credit card. This will generate a fuel receipt that will contain documentary evidence that the aircraft was at this location on a specific date. Additionally, a statement will be needed from the passenger onboard the aircraft during the “first functional use” flight. Depending upon the type of exemption you are claiming the aircraft may or may not be allowed into California.

If the foregoing process and documentation are properly completed and collected, the “first functional use” requirement should be adequately fulfilled. The smallest variation could mean disaster for the tax exemption.

The “first functional use” is only one of the small, yet critical, parts of the California use tax exemption process. There are many aspects which must be completed successfully and documented in order to secure the exemption. ACE will guide the purchaser through the process and ensure the success by monitoring each aspect of the exemption requirements.

Unless otherwise expressly indicated, any advice contained herein was not written and is not intended to be used, and cannot be used, for the purpose of avoiding any sales or use tax, interest or penalty that may be imposed. To be certain the exemption requirements are accurate for your specific situation, call one of our tax experts to discuss.

Other articles will be coming out periodically to explain other aspects of the California sales and use tax laws, regulations, legal decisions, exemptions, or other related matters. If you have a specific sales and use tax topic that you would like discussed or explained please send us an email to [joe@aero-tax.com](mailto:joe@aero-tax.com).

*This article was written by Joe Micallef, CEO of Aero-tax Compliance Experts, LLC (ACE). ACE's experts have helped thousands of clients, many of which have returned to them for additional benefit from this specialized and highly effective exemption service. Don't wait until it's too late, let the professional staff at Aero-tax Compliance Experts, LLC show you how to ACE Your Exemption, Refund or Appeal! If you have any questions regarding this article, other sales and use tax issues, or want to know if you qualify for an exemption or refund, contact our tax experts at (916) 647-6407 for your FREE CONSULTATION, or visit us on the web at [www.Aero-tax.com](http://www.Aero-tax.com).*