“Underground Regulation” is main basis to deny tax exemption

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Any potential aircraft owner needs to be aware of the following California State Board of Equalization (BOE) practice if you plan on, or are, claiming an exemption pursuant to Regulation 1620 of the Revenue and Taxation Code.

Our research has revealed that a majority of claimed exemptions pursuant to Regulation 1620 are being denied primarily due to the failure of taxpayers to properly complete the first functional use requirement as outlined in an internal BOE memorandum which is only an interpretation of one BOE employee.

Currently, Revenue and Taxation Code Regulation 1620 outlines pertinent requirements of the exemption process, which include “first functional use” outside of California. The referenced regulation states in part: “An aircraft purchased outside of California which is brought into California is regarded as being purchased for use in this state if the first functional use of the aircraft is in California. When the aircraft is first functionally used outside of California the aircraft will nevertheless be presumed to be purchased for use in this state if it is brought into California within the first 90 days after its purchase.”

So, what is first functional use? First functional use as defined by Regulation 1620 (b)(3) of the Revenue and Taxation Code states that first functional use is “use for which the property was designed.” Pursuant to the Revenue and Taxation Code Law section 6274 an aircraft is defined as “any contrivance designed for powered navigation in the air except a rocket or missile.” Therefore, logically speaking, an aircraft is designed to fly...right? Not according to the internal memorandum.

A rogue Board of Equalization employee has taken the task of single handedly changing these laws and regulations. Pursuant to this internal memorandum, the BOE adopted a new “underground regulation” which changes the definition of what aircraft are designed for based on various aircraft manufacturer’s web site’s and how they market their aircraft to the public.

Contained in the memorandum it states that aircraft with six (6) or fewer seats (including pilot and co-pilot) are regarded as personal aircraft and the first functional use of these aircraft is simply flight as outlined by current laws and regulations on the books. Accordingly, if this size of aircraft is first flown outside of California it will be regarded as being first functionally used outside of California. However, aircraft that are outfitted with seven (7) or more seats (including pilot and co-pilot) are regarded as being designed for business use. Therefore, these aircraft are not first functionally used until they carry passengers or cargo as outlined in the memorandum. Consequently, the first functional use for aircraft with more than six (6) seats is now considered as making a flight with a passenger (excluding other flight crew) or cargo on board. Therefore, the aircraft must be first flown outside of California with at least one true passenger or cargo. Yet, regardless of size, if the aircraft is first flown at all inside of California the first functional use will be regarded as being inside of California.

In addition, the BOE has, at the detriment of taxpayers, applied this new underground regulation retroactively meaning the BOE is holding taxpayers liable for the tax based on the new standard of first functional use for purchases that occurred prior to the adoption of this underground practice.

We believe the foregoing practices are completely inappropriate without conducting the proper regulatory hearings and administrative processes as outlined by law, which also includes notifying the public. The BOE has again failed to follow proper procedures and it is having a negative effect on the unsuspecting taxpayer.

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