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**Missouri Supreme Court Offers Additional Clarification for Common Carriers -**

**When Does Lease Constitute a Sale?**

**By William R. Borgmeyer**

An aircraft leasing structure is an important tool for aircraft owners to ensure proper compliance with Federal Aviation Administration (“FAA”) regulations, manage risk, monetize their investment, and achieve tax efficiency. Missouri is one of many states that offer certain tax advantages for properly structured leasing arrangements. Under Missouri law, the original purchase of the aircraft and subsequent lease of the aircraft may be exempt from Missouri sales and use tax. Taxpayers have availed themselves of this arrangement for years, though the Missouri Department of Revenue’s more recent challenges to these structures have necessitated the involvement of the Missouri Supreme Court.

To set the stage, a taxpayer may purchase an aircraft and then look to engage in a dry lease of that aircraft with a common carrier. There are two potential taxable transactions: (1) the purchase of the aircraft, which may be subject to sales or use tax; and (2) the subsequent lease of the aircraft, which may be subject to sales tax. Notably, under certain circumstances, the subsequent lease may qualify as a sale, meaning the initial purchase may be eligible for Missouri’s sale for resale exemption. In addition, leases to common carriers in Missouri are exempt from tax under Missouri’s common carrier exemption.

The Department has taken this general exempt structure to the Missouri Supreme Court three times in the past six years. Cooling & Herbers, P.C. successfully defended the first of those cases, *Five Delta Alpha, LLC v. Dir. of Revenue*, 458 S.W.3d 818 (Mo. 2015).

Most recently, in its March 2021 ruling in *APLUX, LLC v. Dir. of Revenue*, 619 S.W.3d 462 (Mo. 2021), the Court handed the Department a partial win, but provided clear advice to taxpayers looking to comply with Missouri tax law while ensuring their transaction is exempt from Missouri sales and use taxes.

At issue in *APLUX, LLC* was the purchase of two aircraft and three subsequent leases. APLUX was a wholly-owned subsidiary of Luxco, a Missouri S-Corporation, created as a sole purpose business to own and lease aircraft. In August 2011, APLUX purchased a Socata TBM 850 aircraft (the “TBM”) and in January 2021 purchased a Cessna 560XL (the “Excel”). The TBM and Excel were both purchased outside of Missouri, but subsequently brought into the state. APLUX did not pay use tax on the purchase of either aircraft, instead remitting sales tax on the lease payments when required, taking the position that the leases constituted a sale and qualified for the sale for resale exemption.

After the purchase of each aircraft, APLUX executed a dry lease with Luxco for the use of each aircraft. Under these two leases, Luxco agreed to pay an annual fee and APLUX would retain “1) the unfettered right to ‘lease’ the Excel to others during Luxco's term; 2) priority use of the Excel; and 3) the absolute authority to determine the Excel's availability for Luxco. Luxco was granted operational control of the Excel only if and when it operated it.”[[1]](#footnote-1) APLUX also executed a dry lease for the Excel with Aero Charter Inc. (“Aero”), a private charter, common carrier, and aircraft management and maintenance company. Aero was permitted to use the Excel for FAA Part 135 charter flights in exchange for a monthly fee. Aero was required to maintain the aircraft and comply with all FAA regulations, retain operational control while operating charter flights, hangar the Excel, and provide insurance. The Excel would remain in Aero’s legal and actual possession when not in use.

Under Section 144.018.1, RSMo., a purchase for resale is exempt if the subsequent sale is one of five enumerated circumstances:

1. Notwithstanding any other provision of law to the contrary, except as provided under subsection 2 or 3 of this section, when a purchase of tangible personal property or service subject to tax is made for the purpose of resale, such purchase shall be either exempt or excluded under this chapter if the subsequent sale is:
2. Subject to a tax in this or any other state;
3. For resale;
4. Excluded from tax under this chapter;
5. Subject to tax but exempt under this chapter; or
6. Exempt from the sales tax laws of another state, if the subsequent sale is in such other state.

A sale can include “any transaction whether called leases, rentals, bailments, loans, conditional sales or otherwise.”[[2]](#footnote-2) The provisions in (1) to (5) were not an issue because, if valid, the resulting lease would either be subject to tax under Section 144.018.1(1), or subject to tax but exempt under 144.018.1(4). What the court did focus on was the definition of a “subsequent sale.” For a lease to constitute a subsequent sale for the resale exemption, there must be “the exercise of any right or power over tangible personal property *incident to the ownership or control of that property.*”[[3]](#footnote-3) Thus, there are essentially two requirements: (1) ownership or control of the property; and (2) an exercise of the right or power over the property.

**APLUX-Luxco Agreements for the TBM and the Excel**

The Court found the first two leases between the parent corporation and APLUX did not transfer sufficient control over the aircraft, stating “the APLUX-Luxco agreement plainly left control of both the TBM and the Excel with APLUX except when actually being flown by Luxco.”[[4]](#footnote-4) APLUX argued that Luxco’s control during the flights was sufficient to qualify as a sale based on the Court’s decision in *Business Aviation,* because “if ‘full’ control need not be transferred, then basically, transfer of any amount of control” should be sufficient.[[5]](#footnote-5) However, the mere operational control during the flights was not satisfactory for the Court. Clarifying its decision in *Business Aviation*, the Court noted that, while the opinion did not list all aspects of custody and control that were transferred, the agreement at issuedid provide for the transfer of “‘complete operational and maintenance control,’ as well as the ‘exclusive care, custody and control of the Aircraft during the term of [the Lease] and at all times during any Part 135 charter operations.’”[[6]](#footnote-6)

Under the Luxco agreements, Luxco never had exclusive care and custody of the aircraft or priority and control, and Luxco did not provide any hangar space, maintenance, or other management services. In addition, APLUX reserved the “absolute right” to decide when the aircraft would be available for Luxco and could lease the aircraft non-exclusively to any third party. While the decision in *Business Aviation* recognized that a lessor could retain some measure of authority without invalidating the lease for tax purposes, “it does not provide that one additionally can retain general and prioritized control.”[[7]](#footnote-7) These two lease agreements that only transferred mere operational control were not qualified as a subsequent sale under the resale exemption and tax would be due on the purchase price of the aircraft.

**APLUX-Aero Agreement for the Excel**

The Court next turned to the third lease at issue, that of the Excel to Aero. Under this lease, while title of the aircraft would remain with APLUX, Aero held the right to possession and use of the Excel during the lease term and retained the right to schedule flights at any time during the lease without the prior consent or approval of APLUX. This contrasts with the Luxco agreement, where APLUX was the one who had a right to use the Excel at any time. Instead, Aero had flight priority except when APLUX had a previously scheduled flight. While maintenance, care, and other hangar services were paid for by APLUX, it was still Aero’s responsibility to ensure the aircraft was compliant with FAA regulations.

These provisions were similar to those at issue in *Business Aviation* and, even though APLUX did retain the right for Part 91 use of the Excel, the balance of all other items of control were transferred to Aero. Based on the Court’s prior decisions, this lease would qualify as a subsequent sale for purposes of the resale exemption.

Ultimately, the Excel is subject to two leases, one that qualifies for the resale exemption and one that does not. The Department attempted to argue that the presence of a non-qualified lease would invalidate the exemption, but the Court disagreed. “Indeed, the issue is not how many non-exclusive leases a purchaser such as APLUX signs with third parties, but rather which party retains control and exercises ‘any right or power’ incident to that control.”[[8]](#footnote-8) Aero’s retention of control and exercise of its rights under the lease was sufficient to qualify as a subsequent sale, exempting the purchase of the Excel from use tax.

While the initial purchase of the Excel would be exempt, the lease revenue may still be subject to tax unless exempt itself. Fortunately, it is well settled that a lease to a common carrier is exempt under the interplay between Sections 144.018.1(4), 144.615(3), and 144.030.2(20). The Excel’s purchase and subsequent lease were therefore entirely exempt from sales and use tax in Missouri.

**Conclusion**

The purchase of an aircraft and subsequent lease to a common carrier may be entirely exempt from sales and use tax under Missouri law. However, the Department will be taking a close look at lease agreements to ensure that they are narrowly tailored to fit within the Court’s decision in *APLUX*. It is a wise decision to have any prospective and existing Missouri dry lease agreements reviewed by experienced aviation and tax counsel to ensure proper compliance with the Missouri resale and common carrier exemptions.

1. *APLUX, LLC v. Dir. of Revenue*, 619 S.W.3d 462 (Mo. 2021). [↑](#footnote-ref-1)
2. *Id., citing* § 144.605(7), RSMo. [↑](#footnote-ref-2)
3. *Id., citing* § 144.605(13), RSMo., (emphasis in original). [↑](#footnote-ref-3)
4. *Id.*  [↑](#footnote-ref-4)
5. *Id.* [↑](#footnote-ref-5)
6. *Id., citing Business Aviation, LLC v. Dir. of Revenue,* 579 S.W.3d 212 (Mo. banc 2019). [↑](#footnote-ref-6)
7. *Id.*  [↑](#footnote-ref-7)
8. *Id.* [↑](#footnote-ref-8)