15-10468

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

BOMBARDIER AEROSPACE CORPORATION,

Plaintiff-Appellant,

—v.—

UNITED STATES OF AMERICA,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS (DALLAS)

MOTION OF NATIONAL BUSINESS AVIATION ASSOCIATION FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF IN SUPPORT OF THE APPELLANT'S PETITION FOR *EN BANC* DETERMINATION

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INTRODUCTION

Pursuant to Federal Rule of Appellate Procedure 29, the National Business Aviation Association ("NBAA"), by and through counsel, requests the Court's leave to file the accompanying brief in support of the petition for *en banc* determination filed by appellant, Bombardier Aerospace Corporation ("BAC"). Counsel for the NBAA has notified counsel for the parties in this case of this motion. Appellant does not object to the granting of this motion. Counsel for appellee has stated that appellee "takes no position on the motion."

I. IDENTITY AND INTEREST OF AMICUS

Founded in 1947, the NBAA is a national not-for-profit membership association incorporated under the laws of and headquartered in Washington, DC. Its mission is to foster an environment that allows business aviation to thrive in the United States and around the world. It is the leading voice for companies that operate general aviation aircraft in support of their business or are otherwise involved in business aviation.

It is the view of the NBAA that the panel's holding in this case will disrupt the fractional aircraft ownership management industry. It encourages disparate treatment among the NBAA's members and allows the Internal Revenue Service ("IRS") to require collection of federal transportation excise tax ("FET") under 26

U.S.C. § 4261 for prior years where there was no authoritative guidance with respect to the collection obligation.

Due to the lack of clarity, the members of the NBAA are facing continued business challenges. Allowing the IRS to assess tax against a collecting agent, such as appellant, where there was no clear guidance on whether such collection was required could destroy a business. Either the collecting agent bears the burden of paying millions of uncollected tax to the IRS or it is forced to collect such amounts from its customers years after the purchases were made, thereby harming its customer relations and reputation in the industry. The duty of clarity, as set forth in the Supreme Court's opinion in *Central Illinois Public Service Commission v. United States*, 435 U.S. 21 (1978), was aimed at avoiding such a harsh result. Moreover, imposing a duty to collect FET on BAC, while allowing others in the industry to avoid such a duty, is unfair and places BAC at a great disadvantage in its business operations.

II. THE NBAA'S BRIEF IS DESIRABLE AND RELEVANT

With over 65 years of experience in the aviation industry and 11,000 members, the NBAA is in a position to aid the Court in determining whether the *en banc* determination is appropriate here.

The NBAA's brief illustrates how the panel's decision contravenes precedential authority and allows the IRS to treat competitors in the aviation

industry differently. Further, the NBAA's brief will aid this Court by addressing how the IRS's prior rulings led to the industry's understanding of the collection obligation at issue in this case and how the panel's decision can lead to devastating results for companies engaged in the aviation industry.

CONCLUSION

For the foregoing reasons, the NBAA respectfully requests that the Court grant this motion for leave to file an *amicus curiae* brief in support of Appellant's Petition for *En Banc* Determination.

Dated: September 14, 2016

Respectfully submitted,

/s/ Stephen D. Gardner

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CERTIFICATE OF SERVICE

I hereby certify that on September 14, 2016, the foregoing motion for leave to file an *amicus curiae* brief – together with the accompanying *amicus curiae* brief – was filed with the Clerk of the Court using the CM/ECF System, which will send notice of such filing to counsel of record who are registered for electronic service, and served by U.S. Mail to:

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/s/ Stephen D. Gardner
Stephen D. Gardner

Counsel for *Amicus Curiae*, National Business Aviation Association

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BOMBARDIER AEROSPACE CORPORATION, Plaintiff-Appellant,
v.
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Case No. 15-10468

CERTIFICATE OF INTERESTED PERSONS

Pursuant to Fifth Circuit Rule 29.2, the undersigned counsel of record certifies that the following persons and entities as described in the fourth sentence of Fifth Circuit Rule 28.2.1 have an interest in the outcome of this case.

1. Bombardier Aerospace Corporation, Appellant[1]
2. Anthony S. Gasaway, counsel for Appellant
3. Robert J. Stientjes, counsel for Appellant
4. Nicholas D. Mosse, counsel for Appellant
5. United States of America, Appellee
6. Julie C. Avetta, counsel for Appellee
7. Michael D. Powell, counsel for Appellee
8. Robert W. Metzler, counsel for Appellee
9. National Business Aviation Association ("NBAA"), movant for leave to file *amicus curiae* brief[2]
10. Stephen D. Gardner of Cooley LLP, counsel for NBAA
11. John B. Hoover of Cooley LLP, counsel for NBAA
12. Adriana Lofaro Wirtz of Cooley LLP, counsel for NBAA

[1] Bombardier Aerospace Corporation is wholly owned by Learjet, Inc., which is wholly owned by Bombardier Aerospace (Holdings) USA Inc., which is wholly owned by Bombardier, Inc., a Canadian corporation.
[2] While the NBAA and its counsel listed herein have an interest in this brief, they do not have a financial interest in this litigation.

The undersigned counsel further certifies that the NBAA is a national not-for-profit membership association that does not have any parent corporation. As a nonprofit association, the NBAA does not issue any stock; therefore, no corporation owns any stock in the NBAA. These representations are made so that the judges of this Court may evaluate possible disqualification or recusal.

/s/ Stephen D. Gardner
Stephen D. Gardner

Counsel for *Amicus Curiae*, National Business Aviation Association

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FED. R. APP. P. 29(c)(4) STATEMENT

The NBAA seeks to file this brief under FED. R. APP. P. 29(a) by leave of this Court.

Founded in 1947, the NBAA, a not-for-profit membership association, is the leading voice for companies that operate general aviation aircraft in support of their business or are otherwise involved in business aviation. Its mission is to foster an environment that allows business aviation to thrive in the United States and around the world.

It is the NBAA's view that the panel's holding in this case will disrupt the fractional aircraft ownership management industry, as it encourages disparate treatment among its members and allows the Internal Revenue Service ("IRS") to require collection of federal excise tax for years in which there was no authoritative guidance with respect to such requirement. The panel's decision results in significant business challenges and an uneven playing field for the NBAA's members.

FED. R. APP. P. 29(c)(5) STATEMENT

No counsel for a party authored this brief in whole or in part. No person other than the amicus made a monetary contribution to the preparation or submission of this brief.

ARGUMENT

En banc determination is appropriate here because the panel decision conflicts with the Supreme Court's decision in *Central Illinois Public Service Co. v. United States*, 435 U.S. 21 (1978), and the decision of the U.S. Court of Appeals for the Federal Circuit in *Executive Jet Aviation, Inc. v. United States*, 125 F.3d 1463 (Fed. Cir. 1997) (the "*EJA Opinion*"). Moreover, the proceeding involves a question of exceptional importance as it could result in disparate collection obligations imposed on similarly situated taxpayers. *See* FED. R. APP. P. 35(a) and (b).

For decades, fractional aircraft ownership management companies ("Fractional Managers") have not collected federal transportation excise tax under 26 U.S.C. § 4261 ("FET") on monthly management fees ("MMFs").[3] The IRS repeatedly has accepted the Fractional Managers' position that MMFs are not subject to FET, but in this case the IRS took the position that Bombardier Aerospace Corporation ("BAC") should have collected FET on MMFs. Because the IRS violated its duties of consistency and clarity, the panel erred in affirming the district court's holding.

[3]Aircraft owners pay fixed MMFs to Fractional Managers for services related to managing and maintaining the owners' aircraft.

I. THE PANEL ERRED IN HOLDING THAT THE DUTY OF CONSISTENCY DOES NOT APPLY

The IRS has a duty to treat similarly situated taxpayers consistently. Where the IRS fails to act in accordance with that duty, the imposition of tax must be rejected. *See International Business Machines Corp. v. United States*, 343 F.2d 914 (Ct. Cl. 1965), *cert. denied*, 385 U.S. 1028 (1966) (taxpayer was entitled to a refund where the IRS issued inconsistent rulings to the taxpayer and its direct competitor).

The IRS issued inconsistent rulings to BAC and its direct competitor, Executive Jet Aviation ("EJA"), now NetJets. In 2004, the IRS issued Technical Advice Memorandum ("TAM") 2004-25-048 (Feb. 17, 2004) (the "BAC TAM") in which it determined that BAC was required to collect FET on MMFs.[4] In 1992, the IRS had issued a TAM to EJA in which it stated that EJA was required to collect FET on amounts paid for air transportation. Tech. Adv. Mem. 93-14-002 (Dec. 22, 1992) (the "EJA TAM"). Subsequent case law establishes that the amount subject to FET under the EJA TAM excluded MMFs.

In *Executive Jet Aviation, Inc. v. United States*, No. 1:95-cv-00007-DGS, slip op. at 5-6, 1996 U.S. Claims LEXIS 233, at *9 (Fed. Cl. Mar. 29, 1996), *aff'd*, 125 F.3d 1463 (Fed. Cir. 1997), the U.S. Court of Federal Claims concluded that

[4] In two subsequent audits of BAC that covered 42 tax periods, the IRS reversed that determination and concluded that BAC was not required to collect FET on MMFs.

the IRS's decision in the case to not treat MMFs as subject to FET represented the government's position as to the "proper measure of the tax." Consistent with this observation, the court in *NetJets Large Aircraft, Inc. v. United States*, 80 F.Supp. 3d 743, 756 (S.D. Ohio 2015), found "a mountain of *undisputed* evidence [showing] that the 1992 [EJA] TAM applies the § 4261 tax to only the occupied hourly fee." The district court concluded that, because the IRS never revoked the EJA TAM, NetJets was not required to collect FET on MMFs. *Id.* at 758.

Since at least the time of the *EJA Opinion*, the industry understood the IRS's position to be that Fractional Managers were not required to collect FET on MMFs. Thus, there was a level playing field and healthy competition among Fractional Managers. By requiring BAC to pay FET on MMFs, after allowing its competitors to not collect the tax,[5] the IRS has created an advantage for BAC's competitors. It is unfair to force BAC to collect millions of dollars from its past customers (or pay such amount itself in the event it is unable to collect from its customers), while competitors in the same industry were not required to do so. This may well be a disadvantage for all of BAC's operations, including its sales of newly manufactured aircraft. Moreover, requiring BAC to collect FET from past

[5] It is the understanding of the NBAA that, in addition to providing favorable treatment to NetJets, which has the largest market share in the fractional ownership program management industry, the IRS has allowed other competitors of BAC, including PlaneSense and CitationShares, to not collect the tax.

customers could result in much needless litigation as past customers assert various defenses to BAC's collection efforts.

II. THE PANEL ERRED IN HOLDING THAT THE IRS DID NOT VIOLATE ITS DUTY OF CLARITY

The Supreme Court explained in *Central Illinois Public Service Co. v. United States*, 435 U.S. 21 (1978), that, because a collecting agent is in a secondary position as to liability for a tax, "it is a matter of obvious concern that, absent further specific congressional action, the [collecting agent's] obligation to [collect] be precise and not speculative." *Id.* at 31.

The IRS can satisfy its duty of clarity by issuing clear precedential guidance, such as revenue rulings. *See id.* at 32. The lack of a clear rule regarding a taxpayer's collection responsibility is particularly apparent when the IRS in a prior year audit of the taxpayer concluded that FET did not need to be collected. *See General Elevator Corp. v. United States*, 20 Cl. Ct. 345 (1990), *appeal not recommended*, AOD 1991-05 (Feb. 22, 1991) (taxpayer not liable for withholding taxes where IRS agent provided letters to a trade association stating that withholding was not required).

A. There Was a Lack of Clear Guidance Regarding Whether MMFs Are Included in the Tax Base

The IRS has failed to satisfy its duty of clarity with respect to the issue of whether MMFs are included in the tax base subject to FET. The IRS's Audit

Technique Guide issued in 2008 stated as an "Important Note" that there was "no published guidance" on this issue. INTERNAL REVENUE SERV., AUDIT TECHNIQUE GUIDE: AIR TRANSPORTATION EXCISE TAX (2008).[6] As discussed above, the IRS issued two conflicting TAMs, which unlike revenue rulings, are not authoritative guidance. *See* 26 U.S.C. § 6110(k)(3). Adding further conflicting guidance, the last sentence of Revenue Ruling 74-123, 1974-1 C.B. 318, provides as an alternative that the IRS will accept as the tax base the amount that the taxpayer would charge to provide charter flights on its own aircraft -- which of course would not include a fixed monthly fee. *See also* Tech. Adv. Mem. 94-04-007 (Oct. 20, 1993) (providing same alternative tax base).

Based on the EJA TAM and the *EJA Opinion*, the industry understood the IRS's position to be that MMFs were not subject to FET. The industry further understood that the IRS's conclusion in the BAC TAM that MMFs were subject to FET was an aggressive position issued by the IRS in the midst of an audit and that precedential guidance would be required. The IRS itself rejected the conclusions in the BAC TAM when it determined that MMFs were not subject to FET at the conclusion of BAC's prior year audits. In light of the foregoing, BAC cannot be

[6] The guide was located at https://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Air-Transportation-Excise-Tax-ATG-Part-1#Fractional, but has been removed. A copy of the guide is included in the Addendum attached hereto. The language quoted above appears at Addendum 29.

deemed to have received precise and non-speculative notice that MMFs are subject to FET.

B. There Was a Lack of Clear Guidance on What Constitutes Commercial Transportation

A single body of law should determine when an aircraft management service provider is engaged in taxable transportation. However, published rulings provide inconsistent guidance.[7]

In *NetJets Large Aircraft, Inc. v. United States*, 116 A.F.T.R.2d 2015-6776 (S.D. Ohio 2015), the court held that "the possession, command, and control test . . . fails to offer deputies [providing aircraft management services] precise and not speculative notice of a collection obligation." In industry meetings on this subject, the IRS Office of Chief Counsel informally agreed that existing rulings do not provide clear guidance. Subsequently, the IRS suspended assessments of FET with respect to aircraft management service providers, and the Treasury Department opened a regulations project to develop clear guidance. *See* DEPARTMENT OF THE

[7] Some IRS rulings focus on the FAA definition of commercial aviation (*i.e.*, the business of transporting persons or property for hire). *See* Rev. Rul. 72-360, 1972-2 C.B. 542; Tech. Adv. Mem. 93-43-002 (Jun. 30, 1993). Other rulings attempt to determine whether the management company has "possession, command, and control" of the aircraft. *See* Rev. Rul. 70-325, 1970-1 C.B. 231 (overturned in *Petit Jean Air Service, Inc. v. United States*, 33 A.F.T.R.2d 74-1526 (E.D. Ark. 1974), *appeal not recommended*, AOD 1975-33 (Mar. 27, 1974)); Tech. Adv. Mem. 94-04-007 (Oct. 20, 1993). Another line of rulings appears to focus on whether the management company acts as the owner's agent. *See* Rev. Rul. 58-215, 1958-1 C.B. 439; Tech. Adv. Mem. 93-47-007 (Aug. 12, 1993); Tech. Adv. Mem. 93-22-002 (Feb. 9, 1993).

TREASURY 2015-2016 PRIORITY GUIDANCE PLAN (Aug. 15, 2016), available at https://www.irs.gov/pub/irs-utl/2015-2016_pgp_4th_quarter_update.pdf. In the absence of clear and non-speculative guidance on this issue, BAC cannot be held secondarily liable for failing to collect FET on MMFs.

CONCLUSION

For the foregoing reasons, the Court should grant Appellant's Petition for *En Banc* Determination.

Dated: September 14, 2016

Respectfully submitted,

/s/ Stephen D. Gardner

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of FED. R. APP. P. 29(d) because this brief is seven and one-half pages long, excluding the parts of the brief exempted by FED. R. APP. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of FED. R. APP. P. 32(a)(5) and the type style requirements of FED. R. APP. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in 14-point Times New Roman font.

/s/ Stephen D. Gardner
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CERTIFICATE OF SERVICE

I hereby certify that on September 14, 2016, the foregoing brief was filed with the Clerk of the Court using the CM/ECF System, which will send notice of such filing to counsel of record who are registered for electronic service, and served by U.S. Mail to:

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/s/ Stephen D. Gardner
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ADDENDUM

Internal Revenue Service
United States Department of the Treasury

Air Transportation Excise Tax - Audit Technique Guide

NOTE: This document is not an official pronouncement of the law or the position of the Service and can not be used, cited, or relied upon as such. This guide is current through the publication date. Since changes may have occurred after the publication date that would affect the accuracy of this document, no guarantees are made concerning the technical accuracy after the publication date.

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Introduction - Air Transportation Excise Taxes

History

The Internal Revenue Code (the Code) imposes a tax on amounts paid for certain transportation of persons and property by air. Before June 28, 1962, a transportation tax applied to amounts paid for transportation by rail, motor vehicle, and water, in addition to amounts paid for transportation by air. Since that date the tax has applied only to the amount paid for transportation by air. Up until 1970, there were a number of exceptions to the tax. In 1970, however, Congress enacted the Airport and Airway Revenue Act of 1970, P.L. 91-258, 1970-1 C.B. 361 (the 1970 Act), eliminating most of these exceptions. The 1970 Act, also established the Airport and Airway Trust Fund, found in section 9502 of the Code.

Congress allowed the tax to expire twice during the mid-1990s. It expired December 31, 1995, and was reinstated August 27, 1996, expired again December 31, 1996, and was

reinstated March 7, 1997.

The Taxpayer Relief Act of 1997, P.L. 105-34 (the 1997 Act), changed the structure of the tax, effective for air transportation after September 30, 1997. The 1997 Act gradually reduced the percentage tax rate from 10% of the amount paid to its present level of 7.5%. The 1997 Act also introduced the domestic segment tax and clarified the rules for amounts paid to provide mileage awards.

The American Jobs Creation Act of 2004, P.L. 108-357 (AJCA), signed on October 22, 2004, and the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, P.L. 109-59 (SAFETEA), signed August 10, 2005, have provided additional exemptions to the tax. In addition, AJCA changed the point of taxation on aviation fuel. This field guide has been updated to reflect these changes.

The air transportation excise taxes were scheduled to be repealed as of October 1, 2007. A number of Acts have provided a continuous extension of the air transportation excise taxes. At the time this guide was written, the tax has been extended through June 30, 2008. This guide will be updated for any legislative changes which occur after June 30, 2008.

Background

Section 4261 of the Code imposes an excise tax on amounts paid for:

- Transportation of persons by air;
- Each domestic segment;
- The use of international travel facilities; and
- The right to award free or reduced rate transportation.

Section 4271 of the Code imposes an excise tax on amounts paid for transportation of property by air.

The air transportation taxes are collected excise taxes under section 4291 of the Code. The amounts collected are deposited into the Airport and Airway Trust Fund. The amounts deposited into the trust fund are primarily used to improve and maintain the nation's airport and air traffic control systems. In addition, taxes on aviation kerosene and aviation gasoline are transferred from the Highway Trust Fund to the Airport and Airway Trust Fund. Generally, a reduced rate of excise tax is imposed on fuel consumed in the aircraft while flying commercial aviation flights. For flights in noncommercial aviation, a higher rate of excise fuel tax is imposed on the gallons of fuel consumed in the flight.

As discussed in this field guide, there are different types and rates of excise taxes imposed on air transportation. Therefore, it is important to determine what type of service is being provided by the air transporter. This determination is to be made on a flight-by-flight basis and is the basis for a number of audit issues.

Involvement in air transportation includes any entity or person flying an aircraft or supplying fuel for the aircraft. This can include, but is not limited to, the following groups:

- Scheduled commercial airlines,
- On-demand air taxi services,
- Charter airlines,
- Charter brokers,
- Fractional Aircraft Companies,
- Management Companies,
- Integrated package delivery companies,
- Travel agencies and tour brokers,
- Businesses and individuals that operate aircraft for their own use,

- Purchasers of airline tickets,
- Internet Intermediaries for air transportation, and
- Marketers of fuel that is used in aircraft.

Document Limitations

This document serves as a field audit guide for excise and other Internal Revenue Agents. The contents of this document are not to be used or Cited as authority for setting or sustaining a technical position. This document is not an official pronouncement of the law or the position of the Service and cannot be used, Cited, or relied upon as such.

Caution should be used in applying existing regulations and revenue rulings to present fact situations. The section 4261 regulations (Facilities and Services Excise Taxes Regulations § 49.4261-1 et. seq.), for the most part have not been revised since 1963, and do not reflect the many changes in the Code since that time. Similarly, many revenue rulings contain out-of-date tax rates and do not reflect the significant changes made in the Code in 1996, 1997, and 2005.

Air Transportation of Persons

Introduction

IRC § 4261 of the Code imposes two different taxes on the amount paid for domestic taxable transportation of persons by air:

- IRC § 4261(a) imposes a percentage tax on the amount paid for taxable transportation of any person (the percentage tax).
- IRC § 4261(b) imposes a segment tax on the amount paid for each domestic segment of taxable transportation (the domestic segment tax).
- IRC § 4261(e)(3) applies the percentage tax to the amount paid for the right to award frequent flyer miles.

The percentage tax and the segment tax are combined together to determine the domestic transportation of persons by air tax and are reported on Form 720, IRS No. 026. The amount reported on IRS No. 026 also includes the tax under IRC §4261(e)(3).

IRC § 4261(c) imposes the international facilities tax on the amount paid for international transportation that begins or ends in the United States, with a reduced rate for departures from Alaska or Hawaii. The international facilities tax is reported on Form 720, IRS No. 027.

The air transportation of persons taxes under section 4261 are collected taxes. The person liable for the tax, the taxpayer, is the person making the payment for the taxable transportation. The person receiving the payment, the collector, is the person that collects the tax and files the Form 720 excise tax return. Collected taxes are discussed further in Chapter 11. Cites: IRC §§ 4291 and 7501 and Reg. § 40.6011(a)-1.

Air Transportation Taxes

The percentage tax and the domestic segment tax are imposed on the amount paid for taxable transportation under IRC §§ 4261(a) and (b), respectively.

IRC § 4262(a) defines taxable transportation for purposes of sections 4261(a) and (b) as transportation by air that meets either of the following tests:

- Transportation that begins and ends in the United States or at any place in Canada or Mexico not more than 225 miles from the nearest point on the border of the

continental United States (the 225-mile-zone rule) or
- Transportation that is directly or indirectly from one port or station in the United States to another port or station in the United States, but only if it is not a part of uninterrupted international air transportation.

Flights over international waters and international lands, such as flights to and from Alaska and Hawaii, require special consideration. Reference Alaska and Hawaii for special rules. **Cite:** IRC § 4262(b).

225-Mile Zone

The term "225-mile zone" means that portion of Canada and Mexico that is not more than 225 miles from the nearest point in the continental United States. Cite: IRC § 4262(c)(2). The 225-mile zone only extends the area of the United States into Canada and Mexico for determination of the taxable transportation. It does not extend the area over the oceans to include any island nations. Note: For a listing of major Canadian and Mexican cities falling within the 225-mile zone, see Appendix B.

Example:

A flight from Minneapolis, MN, to Toronto, Canada, which is within the 225-mile zone, is considered to be taxable transportation for imposition of the taxes under sections 4261(a) and (b). This is true even though the aircraft has left the United States and has entered into Canada.

Uninterrupted International Air Transportation

Generally, uninterrupted international air transportation is defined as any transportation that does not both begin and end in the United States, and in which the scheduled interval between arrival and departure at any airport in the United States 12 hours or less. Cite: IRC § 4262(c)(3).

Example:

A flight departs Paris, France, and arrives in New York, NY. The passenger must change planes for his connecting flight to Dallas, Texas, which connects to a flight to Cancun, Mexico. Cancun is not located within the 225-mile zone. The scheduled time between arrival in New York and departure to Dallas is 3 hours and the scheduled time in Dallas until the flight to Cancun leaves is 4 hours. In this case, the taxes under sections 4261(a) and (b) do not apply because the flight between New York and Dallas is uninterrupted international air transportation.

However, if the passenger is scheduled to spend a couple of days in New York before continuing on to Dallas, where the passenger spends 13 hours, the flight sequence is broken down into three flights: one from Paris to New York, the second from New York to Dallas, and the third from Dallas to Cancun. The passenger's flights would be subject to the taxes on air transportation. In this case, the percentage and domestic segment taxes under sections 4261(a) and (b) would be imposed on the flight between New York and Dallas and the international facilities tax imposed by section 4261(c) would be imposed on the flights from Paris to New York and again from Dallas to Cancun.

Location of Payment for the Air Transportation

If the payment for the taxable transportation of persons by air is made within the United States, then the percentage and domestic segment taxes will be imposed on flight segments

which take-off and land in the United States and/or the 225-mile zone. However, if a payment is made for transportation of persons by air outside the United States, the percentage and segment taxes will apply to transportation which begins and ends within the United States. Cite: IRC § 4261(e)(2).

Example:

A flight from Toronto, Canada, to Vancouver, Canada, both of which are within the 225-mile zone, is considered to be taxable transportation for imposition of the taxes under sections 4261(a) and (b) if the payment for the air transportation is made within the United States. However, if the payment for the flight is made in Canada, the percentage and segment taxes will not apply to the flight.

No Amount Paid for Air Transportation

As a general rule, all amounts paid for the air transportation of persons are subject to tax. Where no amount is paid for air transportation, such as when the transportation is obtained by the redemption of frequent flyer miles, the transaction is not subject to the percentage tax, the domestic segment tax, or international facilities tax. Cite: Rev. Rul. 84-12, 1984-1 C.B. 211. Similarly, where an airline provides its employees with free air transportation, the tax does not apply. However, if the employee pays any amount for the flight, the amount paid is subject to tax. Cite: Rev. Rul. 70-381, 1970-2 C.B. 270.

Open Jaw Transportation

Round trip air transportation is considered to be two trips, the trip from Point A to Point B and the return trip from Point B back to Point A. Cite: IRC § 4263(e). When the round trip is to an international destination, the departing and returning flights are considered to be two separate trips and the international facilities tax is imposed on each of the trips, the departing trip and the returning trip.

"Open jaw" transportation occurs when either (1) the return trip of an international flight is to a point other than the original departure point within the U.S., or (2) the return trip of an international flight to the original departure point within the U.S. departs from a point other than the original specified destination. For example, X departs from Point A, a domestic location, to Point B, an international location, and returns from Point B to Point C, another domestic location. If the distance between domestic points (Points A and C) is less than the distance of the shorter leg traveled (Points A to B, or Points B to C), the flight pattern is considered to be open jaw transportation and to be two separate international flights. In this case, the international facilities tax under section 4261(c) is imposed on each flight. This is discussed in the example below.

Example:

A trip from New York to Panama and from Panama to New Orleans is considered to be two international flights because the distance of the open jaw (New York to New Orleans) is shorter than the distance between Panama and New Orleans (the shorter of the two segments traveled). Therefore, the international facilities tax is imposed on the flight from New York to Panama and again on the flight from Panama to New Orleans.

On the other hand, when a flight departs from Point A, a domestic location within the United States, and lands at Point B, an international location outside of the 225 mile zone, and then returns from Point B to Point C, a different domestic location within the United States, and the distance between Points A and C is longer than the distance traveled between Points A and B, or Points B and C, the flight pattern is considered to be one domestic trip from Point A to

Point C. In this case, the percentage and domestic segment taxes imposed under sections 4261(a) and (b) apply. This is discussed in the example below:

> Example:
>
> A trip from New York to Bermuda and from Bermuda to Miami is considered to be one domestic flight from New York to Miami. The "open jaw" between New York and Miami is in the U.S. and the distance between New York and Miami is greater than the shorter segment traveled (Bermuda to Miami). Therefore, the percentage and domestic segment taxes under sections 4261(a) and (b) are imposed.

Exclusions from Taxable Transportation

The term "taxable transportation" does not include that portion of any transportation by air which meets **all four** of the following requirements:

1. such portion is outside the United States;
2. neither such portion nor any segment thereof is directly or indirectly-
   A. between (i) a point where the route of the transportation leaves or enters the continental United States, or (ii) a port or station in the 225-mile zone, and
   B. a port or station in the 225-mile zone;
3. such portion-
   A. begins at either (i) the point where the route of the transportation leaves the United States, or (ii) a port or station in the 225-mile zone, and
   B. ends at either (i) the point where the route of the transportation enters the United States, or (ii) a port or station in the 225-mile zone; and
4. a direct line from the point (or the port or station) specified in paragraph (3)(A), to the point (or the port or station) specified in paragraph (3)(B), passes through or over a point which is not within 225 miles of the United States.

Cite: IRC § 4262(b).

This exclusion generally comes into play for flights between Alaska and Hawaii and for flights between the continental United States or the 225 mile zone to Alaska and Hawaii. Flights between the continental United States and the states of Alaska or Hawaii fly over international waters or land. Therefore, the amount paid must be apportioned between the portion of the flight which flies over the United States and the portion of the flight which flies over international territories. This issue is discussed further in Chapter 9, Alaska and Hawaii.

Percentage Tax

As of October 1, 1999, IRC § 4261(a) imposes a tax of 7.5 percent on all amounts paid for taxable transportation, the percentage tax. The tax is imposed on amounts paid in cash, paid by property, or paid in barter situations. The tax is imposed at the time payment is made for the flight, not on the date of the flight itself.

Payments Subject to Tax

Amounts paid for air transportation include the following:

- Charges for layover or waiting time,
- Deadhead Service - Movement of an empty aircraft,
- Additional amounts paid to change the class of a ticket,
- State sales taxes - In Rev. Rul. 73-344, 1973-2 C.B. 365, the sales tax was imposed on the seller rather than the purchaser of air transportation. Thus, the amount paid by

the purchaser for such sales tax is part of the 'amount paid' for air transportation.

- Cash fares - Cash is paid and no ticket is issued.
- Scrip books - Tax applies to the amount paid when the scrip book is purchased, not when it is used.
- Additional charges - Amounts paid for changing the route or destination, extending the time limit of a ticket, changing the class of accommodations, or providing exclusive occupancy of a section, etc. are subject to the tax.
- Commutation or season tickets - Commutation or season tickets are subject to the tax where a single trip is 30 miles or more and the ticket is good for more than 1 month. Tax is collected from the purchaser at the time of payment, not when the tickets are used.
- Prepaid exchange or similar order for transportation - The tax applies to the amounts paid for prepaid orders, exchange orders, or similar orders for transportation. Additional amounts paid in procuring transportation in connection with the use of prepaid orders, exchange orders, or similar orders, are likewise subject to tax.
- Combinations of rail, motor vehicle, water, or air transportation - The tax applies only to the portion of transportation that is by air. Taxability of tours and travel vacation packages is discussed further in Chapter 8, Tour Operators and Travel Agencies.
- Chartered conveyances - The tax is imposed on the amount paid for a chartered aircraft. Taxability of aircraft charters is discussed further in Chapter 5, Management Companies and Charters. However, if the owner of an aircraft sells transportation to a charterer then no tax will be due on the amount paid to the owner but the owner must inform the charterer of the charterer's liability for collecting and accounting for the tax on the amount paid to him.
- Payments remitted to air transportation providers in foreign countries by persons in the United States – Where payments to a foreign entity that provides taxable transportation of persons by air are made by the purchaser through payment from within the United States, the payment is considered to be made within the United States, and tax applies.

Cite: IRC § 4262(d) and Facilities and Services Excise Taxes Reg. § 49.4261-7 provides specific examples of methods of payment that are subject to tax.

Frequent Flyer Miles

The percentage tax applies to any amount paid to an air carrier or related person, whether in cash or in kind, for the right to award free or reduced rate air transportation. Cite: IRC § 4261 (e)(3). An example of this type of transaction is if a credit card company purchases miles from a carrier for the right to award the frequent flyer miles to its customers as a premium. Other entities which purchase miles include hotels, rental car companies, telecommunications companies, other foreign and domestic airlines, and passengers.

The percentage tax is computed based on the gross amount paid for the right to award frequent flyer miles. No bifurcation or division of the amounts paid between the frequent flyer miles and costs such as marketing is allowed. Limited guidance has been provided in Rev. Rul. 2002-60, 2002-2 C.B. 641; and Notice 2002-63, 2002-2 C.B. 644. Should an issue concerning the bifurcation, or division, of frequent flyer mile purchases occur, please contact the Air Transportation EIS or the Policy Analyst assigned to Air Transportation Taxes for assistance.

Travel Card Programs

Under an air travel card program, the customer purchases a travel card for a set fee. The travel card allows the customer a certain number of hours of flying time or value of flights on the air transporter's aircraft. Since the travel card is an amount paid for air transportation, the amount paid for the card is generally considered taxable under section 4261(a) when the card is purchased. Reference Travel Card Programs for additional information on this issue.

Demonstration Flights

Often, an air charter company is also in the business of selling aircraft. Because of the high cost of operating the aircraft for a demonstration flight, the air charter company will charge the prospective buyer a fee for the demonstration. Many times there is no tax collected on these demonstration flights. However, Revenue Ruling 68-256, 1968-1 C.B. 489,, provides that when a prospective purchaser makes a payment for a demonstration flight, the amount paid is an amount paid for taxable transportation. Therefore, under those circumstances, amounts paid for demonstration flights are taxable.

Developing Issues

Other products are continually being developed by the industry. For example, recent developments have included gift certificates, gift cards, and passes for unlimited travel for certain periods of time. Request copies of contracts, including the terms and conditions, to determine the important facts concerning the product under review. If needed, contact the Air Transportation EIS or Analyst for assistance.

Segment Tax

In addition to the percentage tax, a segment tax is imposed on each domestic segment of transportation of persons by air under section 4261(b) (except to or from a rural airport). A domestic segment is any segment consisting of one takeoff and one landing. In addition, the segment must be a part of taxable transportation described in section 4262(a)(1). Therefore, the segment tax applies when the air transportation begins in the United States or the 225-mile zone and also ends in the United States or the 225-mile zone. The tax is imposed on each person on board the aircraft and for each taxable segment flown. Cite: Rev. Rul. 2002-34, 2002-1 C.B. 1150.

Example:

Company charters an aircraft for 200 passengers. The aircraft flies round-trip from Oklahoma City, OK, to Memphis, TN. The segment tax is computed based on 400 segments (200 passengers times 2 segments). Assuming that all payments were made during 2006, the total segment tax would be $1,320 (200 persons times 2 segments times $3.30 tax rate).

Domestic Segment Tax Rates

Date of Payment	Tax Rate
During 2003	$ 3.00
During 2004	$ 3.10
During 2005	$ 3.20
During 2006	$ 3.30
During 2007	$ 3.40
During 2008	$ 3.50

During 2003 and thereafter, the segment tax is adjusted by the cost of living index determined under IRC § 1(f)(3). The segment tax is imposed when the payment is made even if the actual flight takes place at a later date. Although IRC § 4261(b)(1) states that the tax rate is determined when the segment begins, IRC § 4261(e)(4)(D) provides a special rule for

segments beginning after 2002, and states that the tax will be based on the rate in effect at the time payment for air transportation is made.

Rural Airports

The segment tax does not apply to a domestic segment beginning or ending at a rural airport. Cite: IRC § 4261(e)(1). NOTE: The percentage tax on the amount paid for domestic transportation **is** applicable to flights to and from rural airports at the 7.5 percent tax rate.

A rural airport, for these purposes, is any airport that had fewer than 100,000 commercial passengers departing in the second preceding calendar year, and

- Is not within 75 miles of an airport that had at least 100,000 commercial passengers departing in the second preceding calendar year; or
- Is receiving essential air service subsidies as of August 5, 1997.
  Cite: IRC § 4261(e)(1)(B).

Beginning October 1, 2005, in addition to the above requirements, a rural airport also includes an airport that:

- Is not connected by paved roads to another airport, and
- Had fewer than 100,000 commercial air passengers on flight segments of at least 100 miles during the second preceding calendar year.
  Cite IRC § 4261(e)(1)(B) (as amended by SAFETEA).

While most rural airports are at least 75 miles away from larger airports, in some states (e.g., Alaska), there are small community airports that are within 75 miles of a larger airport but are not connected by paved roads. Passengers who need to go to the larger airport cannot drive but have to fly to get there; thus, prior to this law change, they paid the segment tax on these flights.

Rev. Proc. 2005-45, 2005-2 C.B. 141, provides guidance in determining if an airport meets the definition of a rural airport. It states:

> The U.S. Department of Transportation, Office of the Secretary of Transportation, in coordination with the Department of the Treasury, periodically publishes an updated list of [rural] airports…. This list may be relied upon to determine whether an airport is a rural airport for purposes of the exception from the domestic segment tax. The updated list of airports that meet the requirements of § 4261 (e)(1)(B) is located at www.irs.gov/businesses/small/topic/index.html under the Excise Tax link. In addition, any airport not listed … qualifies as a rural airport if it meets the requirements of § 4261(e)(1)(B). [Rev. Proc. 98-18, 1998-1 CB 435, is obsoleted.]

Changes in Segments by Reason of Rerouting

If transportation is purchased between two locations on specified flights, and there is a change in the route which alters the number of domestic segments, but there is no change in the amount charged for the transportation, then there is no change in the domestic segment tax imposed. For example, if the aircraft is rerouted to another airport due to weather conditions en route to its final destination, there is no change in the domestic segment tax imposed. Cite: IRC § 4261(b)(3).

> Example:

> The “A” family books a flight from Seattle, WA, to Orlando, FL. The itinerary specifies a stopover in Salt Lake City to change planes on both legs of the trip. The family pays for the tickets, including the segment tax for 4 segments (Seattle to Salt Lake City plus Salt Lake City to Orlando plus Orlando to Salt Lake City plus Salt Lake City to Seattle).
>
> Between Salt Lake City and Orlando, the pilot is directed to land the plane in Houston due to mechanical problems. This unscheduled stop in Houston creates an additional segment.

Since the additional segment was due to an unscheduled change in the flight pattern and no additional charge was imposed on the family, the segment tax for the additional segment is not imposed.

International Travel Facilities Tax

IRC § 4261(c)(1) imposes a tax on any amount paid for the transportation of any person by air that begins or ends in the United States. This tax is imposed at the time that the air transportation is purchased. The international facilities tax is imposed whether the payment for transportation is made inside or outside of the United States and whether the transportation provider is a domestic or foreign entity. The tax rate is indexed for inflation, as shown in the chart below..

Tax Rates

Tax Period	International Facilities Tax	IRC § 4261(c) Departures to/from Alaska and Hawaii
During 2003	$ 13.40	$ 6.70
During 2004	$ 13.70	$ 6.90
During 2005	$ 14.10	$ 7.00
During 2006	$ 14.50	$ 7.30
During 2007	$ 15.10	$ 7.50
During 2008	$ 15.40	$ 7.70

Alaska and Hawaii

As noted in the chart above, a reduced international facilities tax is imposed on departures only for flights between the continental United States, and Alaska or Hawaii. Cite: IRC § 4261 (c)(3). See the discussion of Alaska and Hawaii for details on the calculation.

Note: Travel between Alaska or Hawaii and a foreign destination, including U.S. possessions, is taxed exclusively as international travel and is subject to the full international facilities tax rate.

Air Carrier Liability

Although air carriers are generally responsible for collection and remitting air transportation taxes, liability for the tax is imposed on passengers. However, if the person paying for the taxable air transportation fails to pay the tax for any reason, the liability for the applicable section 4261 taxes is imposed on the air carrier providing the initial segment of air transportation that begins or ends in the United States. Cite: IRC § 4263(c). **Note:** Air carrier liability does not apply to the tax on amounts collected for the transportation of property under IRC section 4271.

Exemptions to the Section 4261 Tax

Introduction

As a general rule, all amounts paid for the air transportation of persons are subject to tax. However, as with other excise taxes, there are exceptions to this rule. This chapter provides a list and a brief discussion of the exemptions to the taxes imposed under section 4261 of the Code.

Helicopter Use

Under IRC § 4261(f), no tax is imposed on air transportation by helicopter for the purpose of-

1. transporting individuals, equipment, or supplies in the exploration for, or the development or removal of, hard minerals, oil, or gas, or
2. the planting, cultivation, cutting, or transportation of, or caring for, trees including logging operations.

The flight is exempt from tax only if the helicopter does not take off from, or land at, a facility eligible for assistance under the Airport and Airway Development Act of 1970, or otherwise use services provided pursuant to section 44509 or 44913(b) or subchapter I of chapter 471 of title 49, United States Code during the flight. In the case of helicopter transportation described in paragraph (1), this subsection shall be applied by treating each flight segment as a distinct flight.

Contact the Airport Manager of the air facility in question to determine if the airport is eligible for assistance under the Airport and Airway Development Act of 1970.

Fixed Wing Aircraft - Forestry

For flights after September 30, 2005, IRC § 4261(f)(2) exempts flights on fixed-wing aircraft used for forestry purposes. Again, the flights are exempt only if the fixed wing aircraft does not take off from, or land at, a facility eligible for assistance under the Airport and Airway Development Act of 1970, or otherwise use services provided pursuant to section 44509 or 44913(b) or subchapter I of chapter 471 of title 49, United States Code, during the flight.

Contact the Airport Manager of the air facility in question to determine if the airport is eligible for assistance under the Airport and Airway Development Act of 1970.

Air Ambulance

Under IRC § 4261(g), no tax is imposed under section 4261 or 4271 on any air transportation for the purpose of providing emergency medical services-

1. by helicopter, or
2. by a fixed-wing aircraft equipped for and exclusively dedicated on that flight to acute care emergency medical services.

NOTE: Whenever an agent is dealing with verification of this exemption, extreme care should be given to protecting and respecting the patient's right to privacy.

Skydiving

Under IRC § 4261(h), no tax is imposed by IRC section 4261 or 4271 on any air transportation exclusively for the purposes of skydiving. Cite: IRC § 4261(h).

Seaplanes

Under IRC § 4261(i), no tax is imposed by section 4261 or 4271 on any air transportation by a seaplane with respect to any segment consisting of a takeoff from, and a landing on, water, but only if the places at which such takeoff and landing occur have not received and are not receiving financial assistance from the Airport and Airways Trust Fund. Cite: IRC § 4261(i), which was added by SAFETEA, is effective for flights after September 30, 2005.

Contact the Airport Manager of the air facility in question to determine if the airport is eligible for assistance under the Airport and Airways Trust Fund.

Small Aircraft on Nonestablished Lines

Under IRC § 4281, the taxes imposed by sections 4261 and 4271 shall not apply to transportation by an aircraft having a maximum certificated takeoff weight of 6,000 pounds or less, except when such aircraft is operated on an established line. For purposes of the preceding sentence, the term "maximum certificated takeoff weight" means the maximum such weight contained in the type certificate or airworthiness certificate. An aircraft is operated on an established line if the route is operated with some degree of regularity. Cite: IRC § 4281.

Sightseeing Flights

IRC § 4281 was amended by SAFETEA to create a "sightseeing" exemption for an aircraft with a certificated takeoff weight of 6,000 pounds or less at any time during which such aircraft is being operated on a flight the sole purpose of which is sightseeing. Cite: IRC § 4281.

Therefore, sightseeing flights on small aircraft are exempt from the domestic air transportation taxes for flights which occur after September 30, 2005. This amendment did not impact the taxability of sightseeing tours on aircraft or helicopters larger than 6,000 pounds.

Affiliated Groups

Under IRC § 4282, if one member of an affiliated group is the owner or lessee of an aircraft, and such aircraft is not available for hire by persons who are not members of such group, no tax shall be imposed under section 4261 or 4271 upon any payment received by one member of the affiliated group from another member of such group for services furnished to such other member in connection with the use of such aircraft.

- Under section 4282(b), the determination of whether an aircraft is available for hire by persons who are not members of an affiliated group shall be made on a flight-by-flight basis.
- Under section 4282(c), the term "affiliated group" has the meaning assigned to the term by section 1504(a), except that all corporations shall be treated as includible corporations (without any exclusion under section 1504(b)).

In summary, for a group to qualify, there must be a parent corporation owning subsidiary

corporations which meet the stock ownership percentage and other requirements specified in section 1504(a). Therefore, an individual owning two separate corporations will not qualify as an affiliated group. Cite: IRC § 4282.

A Schedule C entity, an individual, and filers of partnership returns do not meet the definition of a member of an affiliated group. For Limited Liability Corporations (LLCs) to be treated as a member of an affiliated group, the treatment of the LLC on its income tax return must be considered. Reference Limited Liability Corporations/Disregarded Entities for additional information.

Charges for Nontransportation Services

Where a payment covers charges for nontransportation services as well as for transportation of a person, such as charges for meals, hotel accommodations, etc., the charges for the nontransportation services may be excluded in computing the tax payable with respect to such payment, provided such charges are separable and are shown in the exact amounts thereof in the records pertaining to the transportation charge. If the charges for nontransportation services are not separable from the charge for transportation of the person, the tax must be computed upon the full amount of the payment. Cite: Facilities and Services Excise Taxes Reg. §§ 49.4261-2(c) and 49.4261-8(f).

Exchange of Prepaid Order for Tickets

A ticket issued pursuant to an exchange order, prepaid order, airline pilot order, or scrip, is not subject to tax where the tax is paid at the time of payment for the order or scrip. Cite: Facilities and Services Excise Taxes Reg. § 49.4261-8(a).

Caretakers and Messengers Accompanying Freight Shipments

The tax on the transportation of persons does not apply to amounts paid for transportation of freight that includes also the transportation of caretakers or messengers for which no specific charge as such is made. Cite: Facilities and Services Excise Taxes Reg. § 49.4261-8(b).

Special Baggage Transportation Equipment

An amount paid for special baggage transportation equipment is not subject to the tax on the transportation of persons if separable from the payment for transportation of persons and if shown in the exact amount of the charge on the records covering the taxable transportation payment. Cite: Facilities and Services Excise Taxes Reg. § 49.4261-8(c).

Excess Baggage

An amount paid for excess baggage traveling with a passenger is not subject to section 4261 or 4271 taxes. Cite: Facilities and Services Excise Taxes Reg. § 49.4261-8(f)(1).

Circus or Show Conveyances

The amount paid pursuant to a contract for the movement of a circus or show conveyance where the amount covers only the transportation of the performers, laborers, animals, equipment, etc., by such conveyances is not subject to the tax on the transportation of persons imposed by section 4261. However, if the contract payment also covers the issuance to advance agents, bill posters, etc., of circus or show scrip books, or other evidence of the right to transportation, for use on regular passenger conveyances, that portion of the contract payment properly allocable to such scrip books or other evidence is subject to the tax on transportation of persons. Cite: Facilities and Services Excise Taxes Reg. § 49.4261-8(d).

Corpses

The tax on the transportation of persons does not apply to the amount paid for the transportation of a corpse, but does apply to the amount paid for the transportation of any person accompanying the corpse. Cite: Facilities and Services Excise Taxes Reg. § 49.4261-8(e).

Caution on Former Exemptions

The exemptions listed under Facilities and Services Excise Taxes Reg. §§ 49.4263-1, 49.4263-3, and 49.4263-4, such as the exemption for commutation tickets, the American Red Cross, and Members of the Armed Forces, have not existed since the 1970 law change, but some printed hardcopies of the regulations often contain copies of these regulations.

Business and Private Aircraft

Introduction

Many individuals and businesses own aircraft that are used for personal and/or business purposes. Usually, these aircraft are operated under Federal Aviation Regulations (FAR), Part 91. This FAA regulation allows noncommercial operators to engage in certain arrangements that may be viewed as a "taxable corporation" under the tax laws without jeopardizing their Part 91 certificates. The differing FAA and IRS definitions can cause confusion among aircraft operators and owners. As a result, aircraft owners often assume that since a flight is not considered commercial for FAA purposes, the same flight is not considered taxable transportation under tax laws. The Service is not bound by other agencies' definitions. Rev. Rul. 78-75, 1978-1 C.B. 340, states that the status of an aircraft operator as a "commercial operator" under FAA regulations does not determine the commercial or noncommercial status of the operator in the application of the aviation fuel and air transportation taxes.

Private Aircraft

When an individual owns his or her own aircraft, use by that individual to fly himself or herself, family members, and friends is generally not a taxable situation for air transportation excise tax purposes. This statement is true as long as the individual does not receive compensation either in the form of cash or property. Once compensation or reimbursement for expenses is received, the owner will generally be considered to have received an amount paid for transportation. As a result, the transportation should be evaluated and the appropriate taxes under section 4261 and 4271 should be imposed on the "customer". This is true even if the owner of the aircraft is an individual and is not normally considered to be in the business of providing transportation of persons by air.

Business Aircraft

Businesses may also own an aircraft that they use in the course of their trade or business. Most business use is to move employees, shareholders, and corporate officers to specified locations for valid business purposes. Some businesses have chosen to purchase an aircraft or an interest in an aircraft. This chapter will discuss the basics of business aircraft ownership. More detailed issues concerning fractional ownership and arrangements with a management company see Management Companies and Charters.

Affiliated Groups

In large corporations with multiple subsidiaries, the parent corporation may form an "aircraft operations" entity to operate the corporate owned aircraft. Under this situation, when the aircraft operations subsidiary provides air transportation to the other entities owned by the

parent corporation, payments for the flights may be exempt from the transportation of persons by air tax.

IRC § 4282 provides an exemption from the section 4261 taxes for amounts paid by one member of the affiliated group to another member of the affiliated group. The term "affiliated group" is defined in section 4282(c). If an outside third party (i.e., not a member of the affiliated group) uses the aircraft, the use is outside of the affiliated group and any amount paid for air transportation is taxable under section 4261 or 4271. This affiliated group exemption is now determined on a flight-by-flight basis.

> Example:
>
> In 2000, Corporation O, a subsidiary of Corporation A, purchases an aircraft for use by members of Corporation A's affiliated group. Corporation S, another subsidiary of Corporation A, uses the aircraft every Tuesday and Wednesday. A book entry is made between Corporation S and Corporation O for the fair market value of the use of the aircraft every month. On Mondays and Thursdays, Corporation V, who does not meet the definition of a member of Corporation A's affiliated group, uses the aircraft and pays the fair market value for the hours it uses the plane.
>
> In this situation, amounts paid for the flights taken by Corporation S are exempt under the affiliated group exemption contained in section 4282. However, the amounts paid for the flights taken by Corporation V do not qualify for the affiliated group exemption and are taxable. The fact that the aircraft is used by Corporation V in between Corporation S's uses does not invalidate the exemption for Corporation S's flights.

Partnerships, Schedule C entities, Schedule F entities, and disregarded entities which have not chosen to be treated as a corporation cannot meet the definition of a member of an affiliated group. Therefore, if a related partnership or other non-corporate entity uses an affiliated group's aircraft, the amounts paid for the use of the aircraft are subject to tax under sections 4261 and 4271.

The same theory holds true when the related partnership or non-corporate entity is the entity that owns or operates the aircraft. In this case, since the related partnership or non-corporate entity does not meet the definition of an entity includable in the affiliated group, the amount paid by any member of the affiliated group that uses the aircraft is subject to the air transportation tax.

Limited Liability Corporations/Disregarded Entities

Limited Liability Corporations (LLCs) are often referred to as "disregarded entities". An LLC is a legal entity formed by a single owner or multiple owners who can be corporations, individuals, or partnerships. An LLC with multiple owners is treated as a partnership required to file a Form 1065, unless it elects to be treated as a corporation. This election is made by the LLC when it files its first income tax return. The LLC has "checked the box" by checking the initial return box on the income tax return. Once the LLC has chosen to be treated as a corporation for income tax purposes, it has the further option of electing s-corporation status. By filing a Form 1065, the entity, by default, has remained a partnership.

In contrast, an LLC with a single owner ("single member LLC") may also elect to be treated as a corporation. However, if the single member LLC chooses not to make this election, it defaults and is absorbed into its owner's tax return. For example, the owner reports the activity on Form 1040 Schedule C, Form 1040 Schedule F, or Form 1120. Once the facts of ownership of the LLC and the income tax reporting of the LLC are determined, the regular excise tax rules concerning the affiliated group exemption may be applied.

Treasury Decision (TD) 9356, published August 16, 2007, amended Procedure and Administration Regulation § 301.7701-2, regarding the treatment of employment and excise taxes for LLCs. The final regulations, which are effective January 1, 2008, provide that single-owner eligible entities that currently are disregarded as entities separate from their owners for federal tax purposes will be treated as separate entities for employment tax, related reporting requirement purposes, and for certain excise taxes, including the taxes in sections 4261 and 4271. Thus, a number of transactions that were previously not taxable may now be subject to these excise taxes.

Interchange Agreements

Interchange agreements commonly occur between aircraft owners usually located in a geographical location. An interchange agreement allows two or more unrelated entities that own aircraft to use the others' aircraft on an as-needed basis. The arrangement provides the entities the ability to use two or more aircraft at the same time or to have their aircraft be used by another party for compensation. This assists in reducing costs of operating the aircraft.

Each entity bears the costs and expenses of operating its own aircraft. Out-of-pocket expenses not directly related to the operation of the aircraft are borne by the entity using the aircraft. In many cases, the interchange agreement works on a barter system, with each entity earning credit for flight time. Although interchange agreements are permitted under FAR Part 91, they may constitute taxable air transportation under IRC § 4261. The fair market value of the barter as well as any payment made will be considered an amount paid under section 4261.

Joint Ownership

Due to the high cost of ownership and maintenance of aircraft, entities often purchase an aircraft jointly with an unrelated party. The joint owners share the fixed costs and pay for their own direct operating expenses. In general, registered owners who pay their pro rata share of the fixed costs and their own direct operating costs are treated as using their own aircraft. Therefore, the flights that they take on their jointly owned aircraft are not subject to air transportation taxes. However, the taxability of their flights might change if the owners should relinquish possession, command, and control of their aircraft. Possession, Command, and Control is discussed in Chapter 4, Aircraft Leases.

The taxability of flights might also change if the joint owners place the aircraft in a partnership and reimburse their flight expenses to the partnership. **NOTE:** Joint ownership is different than fractional ownership which is discussed in Chapter 6, Fractional Ownership Issues.

Personal Use of Business Aircraft by Individuals

When a business aircraft is available to employees, partners, shareholders, directors, and officers for personal use, there may be taxable transportation of persons by air. In any case where the individual reimburses the owner entity for the value of the flight or for all or part of the expenses of the flight, a payment for air transportation has been made and the amount paid to the owner entity for the flight is subject to the air transportation excise tax. However, if the owner entity maintains possession, command, and control of the aircraft and if the individual has the value of the flight included in their income, no payment has been made by the flight recipient and there is no tax due under section 4261. Cite: Rev. Rul. 76-431, 1976-2 C.B. 328.

Aircraft Leases

Introduction

Often, the owner of an aircraft will lease the aircraft to another party to reduce the costs

attributable to owning the aircraft. The lease can be a permanent lease, where the lessee always has use of the aircraft, for a single flight only, or some arrangement in between. Amounts paid under these leases may be subject to air transportation taxes under section 4261 or 4271. The determination of whether the lease payment is subject to air transportation taxes depends on whether the owner of the aircraft transfers possession, command, and control of the aircraft to the lessee. This chapter will cover the basics of leases.

Possession, Command, and Control

Determining who has possession, command and control of the aircraft is the most important item in determining the taxability of the transaction and the entity responsible for collecting the section 4261 or 4271 taxes. Possession, command and control is determined by looking at:

- Who chooses and pays for the pilots,
- Who provides maintenance on the aircraft,
- Who controls the scheduling of the aircraft, and
- Who pays for the insurance and other expenses of the aircraft.

An analysis of these criteria can generally determine who has possession, command, and control of the aircraft in order to determine whether taxable transportation has been provided. Generally, the entity having possession, command, and control is considered the entity selling transportation and is the collector of the air transportation taxes. Cite: Rev. Rul. 60-311, 1060-2 C.B. 341, Rev. Rul. 58-215, 1958-1 C.B. 439, and Rev. Rul. 68-256, 1968-1 C.B. 489. This may result in the actual owner of the aircraft relinquishing possession, command, and control of the aircraft and becoming subject to the taxes under sections 4261 and 4271.

Leases

A look at how the lease of the aircraft is structured can provide information as to who has possession, command, and control of the aircraft.

Wet Lease

Under a wet lease, the lessor includes the pilot, crew and other services as part of the lease arrangement. Generally, under a wet lease the lessor has not given up possession, command, and control of the aircraft.

> Example:
>
> V Corporation purchases an aircraft for use in its operations. Occasionally, V Corporation leases its aircraft to outside third parties. Since V Corporation's insurer will not offer coverage for the aircraft unless one of V Corporation's certified and approved pilots is in control of the aircraft, the lease is established as a "wet lease". Therefore, V Corporation's pilots will pilot the aircraft when it is leased to an unrelated third party. V Corporation also has the right to schedule the aircraft and to bump an outside third party should V Corporation need the aircraft on the date an outside third party had already leased it.
>
> In this case, V Corporation has maintained possession, command, and control of the aircraft. The unrelated third party is liable for tax under section 4261 or 4271, on its amount paid and V Corporation is responsible for collecting and remitting the tax.

Dry Lease

Under a dry lease, the lessor supplies only the aircraft. The lessee furnishes his own pilot and crew. The lessee is also responsible for aircraft operation costs and for all fees, such as landing fees, incurred on the flight. Under a dry lease, possession, command, and control of the aircraft is transferred to the lessee.

Example:

A corporation finds that it is not using its corporate aircraft as often as it would like. In addition, the costs of operating the aircraft, maintaining the crew, and performing maintenance on the aircraft is more than the corporation can afford. In order to reduce these costs and to keep the aircraft in the air as much as possible, the corporation leases the aircraft to an aircraft management company. At the same time, the corporation enters into an agreement with the management company for the management company to provide the pilots of the aircraft, schedule the aircraft, and maintain the aircraft.

In this case a dry lease has been established. Possession, command, and control of the aircraft has transferred to the aircraft management company. Lease payments received by the corporation from the aircraft management company are not subject to the transportation of persons excise tax as the amounts are for rental of the aircraft.

Additional Cites for Lease Issues

The following citations address various issues concerning the lease of an aircraft:

Rev. Rul. 57-545, 1957-2 C.B. 749: Amounts paid by a company for the lease of an aircraft, including operation and maintenance expenses, for transporting the company's personnel are subject to the tax imposed by section 4261.

Rev. Rul. 58-215, 1958-1 C.B. 439: A corporation that owns an aircraft and appoints an airline company to service, maintain, and operate the aircraft for the purpose of transporting the corporation's personnel is not being furnished transportation by the airline company and is not subject to the section 4261 tax.

Rev. Rul. 60-311, 1960-2 C.B. 341: An owner of an aircraft is furnishing taxable transportation if the owner:

1. Leases the aircraft with pilots to others for transportation of persons by air;
2. Retains elements of possession, command, and control of the aircraft; and
3. Performs all services in connection with the operation of the aircraft.

Rev. Rul. 68-256, 1968-1 C.B. 489: Applicability of the excise tax on the transportation of persons by air to payments made in connection with flights for demonstration purposes,

Rev. Rul. 70-325, 1970-1 C.B. 231: Applicability of the tax where an individual leases a plane to a corporation in which he is the sole stockholder.

Rev. Rul. 2005-64, 2005-39 I.R.B. 600: If an individual, through a subchapter S Corporation, leases an aircraft for another's use, supplying neither pilot nor crew under a dry lease, then the section 4261 tax does not apply. However, if the S corporation provides a pilot and crew to operate and maintain the aircraft, and food and fuel for travel under a wet lease, then the section 4261 tax applies.

Management Companies and Charters

Introduction

Jet aircraft are expensive to purchase and maintain. After the aircraft is acquired, owners usually either have to hire an aircraft management company or create an internal flight department. An internal flight department offers the highest degree of control, but also a higher level of complexity and cost. An aircraft management company will serve as an external flight department and provide key services requiring aviation competence, including hiring and training pilots, flight planning, aircraft scheduling, maintenance, and fueling.

The hiring of an aircraft management company may create taxable situations for the aircraft owner or for the management company. Since the issues for aircraft charter companies tend to mirror the issues for aircraft management companies, the issues for both types of entities will be presented together in this Chapter.

Definition of Commercial Aviation

When dealing with corporate aircraft, aircraft management companies, and aircraft charter companies, it is important to distinguish between two different definitions of “commercial aviation”. The Federal Aviation Administration (FAA) defines commercial aviation as the carriage of persons or property by air for profit. This definition is in contrast to the Service’s definition, which simply requires that the carriage by aircraft be undertaken for compensation. To add to the confusion, the FAA’s Federal Aviation Regulation (FAR) allows Part 91 noncommercial operators the ability to engage in certain aircraft carriage arrangements which could be viewed as commercial aviation under FAA rules, without jeopardizing the Part 91 certificate. The differing definitions can cause confusion among aircraft operators and owners.

Flight departments often assume that, since a flight is not considered as a commercial flight for FAA purposes, the flight is not considered commercial for any other purpose. However, the Service is not bound by other agencies' definitions of commercial and noncommercial aviation. Rev. Rul. 78-75, 1978-1 C.B. 340, states that the status of an aircraft operator as a “commercial operator” under FAA regulations does not determine the commercial or noncommercial status of the operator in the application of the aviation fuel and air transportation taxes. Therefore, the Service’s definition of commercial aviation, carriage of persons or property by aircraft for compensation, is to be applied when determining taxability for excise tax purposes under IRC sections 4261 and 4271.

Aircraft Charter Companies

There are a number of entities that own aircraft and are in the business of chartering aircraft out to unrelated third parties. The charters can occur on an as needed basis or can be set to occur on a regular schedule. The air transportation services provided, as well as the amounts paid for the air transportation of persons or property, are agreed to by the parties and are noted in an aircraft charter agreement. When a flight is needed, the business entity or individual will contact the charter company to arrange a flight through the charter company’s flight department. The charter company will bill the business entity or individual chartering the flight for the flights flown based upon the terms of the aircraft charter agreement, often on a monthly basis. The aircraft charter company will also enter into charter agreements with individuals and smaller businesses on a one-time only or on an as needed basis. In many cases, an aircraft charter can be more economical than using a commercial airline.

Air Charter with Wet Lease

An air charter company may wet lease the aircraft to the charterer. In a wet lease, the charter company provides the pilot and crew, as well as other services, as a part of the lease arrangement. In this case, the charter company maintains possession, command, and control of the aircraft. Therefore, the charter company is responsible for collecting and remitting the applicable air transportation excise taxes imposed on the amounts paid for air

transportation under sections 4261 and 4271. However, if the person chartering the aircraft intends to charge unrelated third parties for air transportation on the aircraft, the air charter company must inform the person chartering the aircraft of its obligation to collect the taxes under section 4261 or 4271 on the amounts paid by the third parties. Cite: Facilities and Services Excise Tax Regs. § 49.4261-7(h).

Taxable Amounts Paid

The amount paid for taxable transportation for an aircraft charter includes the actual amount paid for the flight plus any payments made for related air transportation services. Such payments include:

- Lease fees – the amount paid for the lease of the aircraft,
- Hourly charges for the operation of the aircraft. The time the aircraft is in operation for the lease is usually determined from the amount of time the aircraft engine is operating plus a stated amount of time before takeoff and after landing for preflight and postflight activities,
- Fuel costs, including surcharges,
- Meals, if not separately stated,
- Charges for pilot or aircraft waiting time,
- Charges for deadhead service (movement of an empty plane to the site where needed or in returning to the charter operator's base airport),
- Charges for crew expenses including meals, hotels, car rentals, etc.
- Sales taxes (see Rev. Rul. 73-344, noted below),
- Landing fees, aircraft parking fees, hangar fees, and other amounts directly related to the flight.

A number of Revenue Rulings have been issued on the items includable in the taxable amount for the domestic air transportation percentage tax. These Revenue Rulings are summarized below:

- Amounts paid for charges in connection with layover time of charter aircraft consisting of an hourly rate plus expenses of the pilot and crew are subject to the air transportation tax. Cite: Rev. Rul. 72-565, 1972-2 C.B. 578.
- State sales tax imposed on sellers of air transportation and passed on to their customers as a separately billed item is part of the amount paid and is includible in the tax base. Cite: Rev. Rul. 73-344, 1973-2 C.B. 365.
- Amounts paid by a federal agency for transportation of its employees to an air charter company for flights on both Government-owned and company planes are taxable under section 4261. The computation of the tax may be based either on the cash received plus the value of the aircraft use and other agency contributions, or a comparable amount for similar services using a company plane. Cite: Rev. Rul. 74-123, 1974-1 C.B. 318.

  Example:

  In 2007, Charter Company A leases its aircraft to Corporation E under a wet lease to fly ten officers of Corporation E on a round trip from Chicago to New York. The lease hours totaled 8 hours for two flights of 4 hours each way. Lease of Aircraft per hour is $2,000, which includes the use of the aircraft and the base cost of the fuel consumed. Due to the increased cost of fuel, Charter Company A also charged a fuel surcharge of $1,000. Costs for the crew to stay in New York while Corporation E's officers attended their meeting totaled $500. Landing and takeoff fees for the round trip flight in the amount of $1,000 were also imposed. Charter Company A also charged Corporation E for 10 meals served on each leg of the round trip flight and separately stated the item on the billing statement.

Corporation E will be billed and Charter Company A will collect and remit $1,455.50 for the air transportation excise taxes imposed on the amounts paid for the round trip flight. The amount of tax is computed as follows:

Expense	TaxableAmount	
Aircraft Charter	16,000	(8 hrs Times $2,000 per hr)
Fuel Surcharge	1,000	
Crew Costs	500	
Landing and Takeoff Fees	1,000	
Total Taxable Fees	18,500	Addition of all of the above
Tax Rate	7.5 %	Times
Total Percentage Tax	**1,387.50** (a)	Equals
Number Taxable Segments	20	(10 employees Times 2 segments)
Segment Tax Rate	3.40	Times
Total Segment Tax	**68.00** (b)	Equals
Total Air Transportation Tax	**1,455.50**	Addition of (a) and (b)

Note: The amount paid for meal service is not taxable because it was separately stated on the billing statement and is not costs of providing air transportation.

Air Charter with Dry Lease

In a dry lease, the person chartering the aircraft provides its own pilot to fly the aircraft leased from the air charter company. A dry lease usually causes the possession, command, and control of the aircraft to shift from the aircraft charter company to the person chartering the aircraft. If possession, command, and control shifts, there is no excise tax imposed on the amounts paid for the air transportation. The aircraft charter company is no longer responsible for collecting and remitting the tax. However, if the person chartering the aircraft intends to charge third parties for air transportation on the aircraft, the air charter company must inform the person chartering the aircraft of its obligation to collect the taxes under section 4261 or 4271 on the amounts paid by the third parties. Cite: Facilities and Services Excise Taxes Reg. § 49.4261-7(h).

Example:

Charter Company A leases its aircraft to Corporation E under a dry lease. Under the lease, Corporation E is responsible for providing a qualified pilot and crew to fly the aircraft as well as all items necessary for the operation of the aircraft during the lease period, including the fuel. In this case, possession, command, and control of the aircraft has shifted from Charter Company A to Corporation E. Charter Company A is not responsible for collecting and remitting the section 4261 and/or 4271 taxes on amounts paid for the lease. However, Charter Company A must notify Corporation E of Corporation E's responsibility to collect and remit the taxes if Corporation E is paid by third parties for air transportation services.

Management Companies

An aircraft management company differs from an aircraft charter company in that a management company's business purpose is to manage the operations of an aircraft. To do this, the aircraft management company will enter into an agreement with a related or unrelated entity to operate and maintain that entity's aircraft. Most often, the aircraft placed into a management agreement is owned by mid- to large-size business entities. The aircraft owner contracts with a management company to place the aircraft into a fleet of aircraft to be leased to third parties when not being used by the owner. Thus, the aircraft may be used more often and generate income to the aircraft owner. In addition, the aircraft owner does not need to maintain a flight department on its payroll to maintain and schedule the aircraft.

Wet Lease to Aircraft Management Company

The aircraft owner may lease the aircraft to the management company under a wet lease. With a wet lease, the aircraft owner pays for all costs attributable to the operation of the aircraft, including the pilot and crew salaries, fuel, insurance, and fees incurred when the aircraft is used. The aircraft owner retains the right to direct the pilots when and where to fly as well as to be able to replace a pilot certified to fly the aircraft. Therefore, the aircraft owner retains possession, command, and control of the aircraft.

The aircraft management company in this case acts as an agent of the corporation. In this capacity, the aircraft management company is not required to collect the air transportation tax on amounts it receives from the aircraft owner. Cite: Rev. Rul. 58-215, 1958-1 C.B. 439; Rev. Rul. 60-311, 1960-2 C.B. 341. The aircraft owner is responsible for collecting and depositing the tax under section 4261 on amounts paid for any use by the management company or on the amounts paid for unrelated third party flights. When the aircraft owner uses its own aircraft, no tax is due.

Example:

Corporation B owns a jet aircraft. Corporation B contracts with Aircraft Maintenance Company D (AMCD) to provide maintenance and hangar space for the aircraft. Corporation B still keeps two pilots and other crew members on its payroll and maintains full ability to direct the times and locations of flights. Corporation B also wants to earn income from the aircraft when the corporation is not using it. Thus, the corporation enters into a contract with AMCD to notify it when an unrelated third party would like to use the aircraft. AMCD receives a $300 fee for each name forwarded. Corporation B's pilots will fly these charters. Since Corporation B retains possession, command, and control of the aircraft, Corporation B is responsible for collecting and remitting the tax on the amounts paid for the charters. No tax is imposed on the amounts paid for services provided by AMCD when Corporation B uses its own aircraft.

Dry Lease to Aircraft Management Company

On the other hand, the aircraft owner may lease the aircraft to the management company under a dry lease. Under a dry lease, the aircraft owner is leasing the aircraft itself and the management company is providing the pilot. The management company will also coordinate all scheduling of the aircraft. In this case, possession, command, and control of the aircraft has been transferred from the aircraft owner to the management company. The management company now becomes responsible for collecting and remitting the air transportation excise taxes under sections 4261 and 4271 on amounts paid for the use of the aircraft.

Under a dry lease, since possession, command, and control has been relinquished by the aircraft owner, amounts it pays for its own flights are taxable. In other words, the aircraft owner's flights are treated the same as flights of unrelated third parties. In this case, the affiliated group exemption from the air transportation tax under section 4282 would not apply because the management company has possession, command, and control. The

management company is basically wet leasing the aircraft back to the aircraft's owner. The tax under section 4261 is calculated on all amounts paid to the management company by the aircraft owner. Taxable fees may include:

- Hourly flight operation charges,
- Aircraft management fees,
- Aircraft maintenance fees for general maintenance, not capital improvements,
- Administrative charges for scheduling the aircraft,
- Pilot and crew salaries,
- Meals, if not separately stated,
- Charges for pilot or aircraft waiting time,
- Charges for deadhead service (movement of an empty plane to the site where needed or in returning to the charter operator's base airport),
- Charges for crew expenses including meals, hotels, car rentals, etc.
- Sales taxes,
- Landing fees, aircraft parking fees, hangar fees, and other amounts directly related to the flight.
- Charges for fuel, including any surcharges.

Cite: Rev. Rul. 58-215, 1958-1 C.B. 439.

Example:

Corporation A enters into a dry lease with Aircraft Management Company D (AMCD) for its corporate jet. Under the dry lease, AMCD maintains the aircraft and provides pilots who are certified to fly the aircraft, as well as a qualified crew. The aircraft is to be made available for third party leases when Corporation A is not using it. All flights are coordinated by AMCD's staff.

In this case, possession, command, and control of the aircraft shifts from Corporation A to AMCD. AMCD is now responsible for collecting and remitting the air transportation taxes imposed under sections 4261 and 4271 on the amounts paid for the use of the aircraft. Since possession, command, and control is held by AMCD, whenever Corporation A, or one of its affiliates, uses the aircraft, the amounts paid for the flight are subject to the section 4261 and 4271 air transportation taxes. In addition, the monthly management fees and all other fees paid by Corporation A to AMCD are subject to the taxes.

Time-sharing/Interchange Agreements

A time-sharing or interchange agreement is an arrangement whereby an aircraft owner wet leases its airplane, with pilot and crew, to another entity. These agreements may be arranged between two or more parties with no assistance from a management company.

A time-sharing agreement occurs when an entity that needs private air transportation enters into an agreement with an unrelated entity that owns an aircraft (usually, but not always, in the same geographical location). These agreements are typically for cash payment for use of the aircraft.

In an interchange agreement, an entity that owns an aircraft enters into an agreement with one or more unrelated entities that also own aircraft. In this case, the unrelated entities trade time on each other's aircraft. Generally, an accounting of flight hours and the value of the aircraft's usage is made at the end of the year end, and any net monies due are paid at the time.

In general, an amount is paid for the expenses specific to each time sharing or interchange flight. These charges are billed by the aircraft owner to the user of the aircraft and may

include:

- Fuel, oil, lubricants, and other additives;
- Travel expenses of the crew, including food, lodging, and ground transportation;
- Hanger and tie down costs away from the aircraft's base of operation;
- Insurance obtained for the specific flights;
- Landing fees, airport taxes and similar expenses;
- Customs, foreign permits, and similar fees directly related to the flight;
- In-flight food and beverages;
- Passenger ground transportation;
- Flight planning and weather control; and
- An additional charge equal to 100 percent of the fuel, oil, lubricants, and other additives.

These amounts are included in the section 4261 tax base unless specifically exempted as discussed in Chapter 2, Exemptions. The taxable amount includes the fees noted above along with the value of the flight. The value of the flight is considered to be taxable because the value of the service and use of the aircraft was received by the user in a barter transaction.

Although a time-sharing agreement flight or an interchange agreement flight is not considered to be a commercial flight for FAA purposes, these arrangements meet the Service's definition of a commercial flight because amounts are paid for the air transportation of persons or property. Therefore, amounts paid (including amounts paid in kind) for the transportation are fully taxable under sections 4261 and 4271.

Introduction to Fractional Ownership

In a fractional ownership arrangement, fractional shares of an aircraft are "sold" to a number of persons/entities. The registered joint owners of the aircraft enter into a contract with a fractional management company to manage the aircraft operations. The fractional management company hires the pilots and pays their salaries.

The issue of whether the fractional owners have surrendered possession, command, and control of the aircraft to the fractional management company must be addressed. The nature of the rights surrendered must be weighed against the nature of the rights retained in order to determine whether the fractional management company is providing taxable transportation. Reference Chapter 6, Fractional Aircraft Ownership for additional information on fractional management companies.

Travel Card Programs

Management companies have created a new twist in providing air transportation services by establishing travel card programs. Under a travel card program, the customer purchases a travel card for a set fee. The travel card allows the customer a certain number of hours of flying time on the air transporter's aircraft. When a flight occurs, the customer's card is debited for the appropriate number of hours of flying time and the customer is charged fees incidental to that flight, such as landing fees and fuel.

Since the air travel card is an amount paid for air transportation in advance, the amount paid for the card is taxable under section 4261 when the card is purchased. The additional fees are taxable under sections 4261 and 4271 when the flight occurs. Segment taxes will also be imposed at the time of the flight, because the number of segments and the number of passengers is determined at that time.

Example:

> Air Charter Company A sells travel cards to customers. The fee to purchase the card is $100,000, which entitles the purchaser to 50 hours of flight time on Air Charter Company A's aircraft. At the time the travel card is sold to a customer, Air Charter Company A must collect and remit the section 4261 tax in the amount of $7,500 (0.075 times 100,000). When a customer uses the card, fees incurred with the flight including pilot and crew costs, landing and hangar fees, and fuel charges are billed. At this time, Air Charter Company A is responsible for collecting and remitting the section 4261 taxes on the additional fees, as well as the domestic segment taxes. Note the special rule in section 4261(e)(4)(D) for calculating the domestic segment tax. If the actual itinerary involves transportation that would be taxable under section 4261(c), use of international travel facilities, contact Counsel for advice.

Note that neither the Code nor any IRS published guidance specifically addresses the issues related to travel card programs.

Charters by Tour Companies

When a tour agency sells a package tour, it may have to collect the section 4261 and 4271 taxes on the payment. Rev. Rul. 75-296, 1975-2 C.B. 440, considers the application of the tax to two situations involving travel agencies. One travel agency (Agency A) is an independent broker that charters an aircraft from an airline and sells tours to individuals and groups. The other travel agency (Agency B), which represents an airline and is under the supervision and control of that airline, is not licensed as a broker. When Agency B sells tours it retains a commission and remits the remainder of the amount collected to the airline. The ruling holds that Agency A is operating as a principal and is required to collect the tax and pay it over to the government. Agency B, because it operates under the control of the airline, is an agent of the airline. As the airline's agent, Agency B must collect the tax and remit it to the airline, which, in turn, must pay it over to the government.

Section 49.4261-7(h) of the regulations provides that a person who charters an aircraft and then charges others for transportation on that aircraft must collect the tax. However, the facts in each case must be analyzed to determine who is purchasing taxable transportation. Cite: Facilities and Services Excise Taxes Reg. § 49.4261-7(h)(1) and (2).

Demonstration Flights

A demonstration flight takes place when a potential buyer rides in an aircraft in contemplation of the purchase of the aircraft. In Rev. Rul. 68-256, 1968-1 C.B. 489, no tax is imposed if the seller of the aircraft provides a free demonstration. On the other hand, if the seller receives any payment (even voluntary) from the potential buyer for the demonstration flight, then payment has been made for taxable transportation, and the taxes under section 4261 apply. In addition, tax may apply if the seller leases an aircraft from a third party for purposes of the demonstration. See Rev. Rul. 68-256.

Examination Techniques

There is a unique approach to conducting an examination of a small air charter company. The most important item is to conduct an in-depth interview to review the operations of the company with an employee or officer. The interview is to be used to determine the following items:

- The type of services provided,
- The types of aircraft flown,
- Whether each aircraft is leased or owned,
- The geographical area covered,
- The types of records kept,
- The services the air charter provider considers to be taxable,

- The services the air charter provider considers to be non-taxable, including the reason for non-taxability of the item,
- The method by which the components of the transportation of persons by air tax is computed,
- Any other information which can be obtained about the business practices.

Additional audit tasks to be performed include:

- Secure a list of all aircraft owned or leased by the company. The information is to include the registration numbers of each aircraft along with the certificated take-off weight of each aircraft.
- Review the flight logs and corresponding invoices looking for untaxed flights and details of untaxed items. Verify that all taxable items are properly accounted for.
    - Note: Be especially alert as to how the air charter provider calculates the segment fees on each flight. The segment fees may be incorrectly calculated on the single charter of the aircraft, instead of the number of segments and the number of passengers per segment. Reference: Rev. Rul. 2002-34, 202-24 I.R.B. 1150.
- Request and review all lease agreements to determine if there are any issues involving wet vs. dry leases. Reference the discussion of leases in Chapter 4, Aircraft Leases.
- Review aviation fuel usage looking for the correct tax rates for the type of flights flown and improper claims and credits. Review the Form 4136 attached to the income tax return, the Form 8849 filed for fuel claims, and the fuel purchase and usage reports.
- Review sales and accounts receivable to ensure all flights are accounted for and for unusual entries.

Some of the common issues encountered include, but are not limited to:

- Items improperly excluded from the tax calculation.
- Flights excluded based on improper exemptions.
- Segment fees calculated improperly.
- Tax on the Use of International Facilities not paid or calculated improperly.
- Improper treatment of wet or dry leases including determination of possession, command, and control of the aircraft.
- Improper treatment of aviation fuel tax rates imposed and claimed.

Fractional Aircraft Ownership

Important Note

Note that neither the Code nor any IRS published guidance specifically addresses the issues discussed in this chapter.

Introduction

Fractional aircraft ownership first appeared in the mid-1980s. It was created due to the increasing costs of aircraft ownership coupled with the complexities of maintaining a modern business jet. Most Taxpayers do not have the expertise or experience needed to deal with the myriad of Federal Aviation Administration (FAA) regulations, in addition to state rules and foreign government requirements. Fractional Management companies have risen to meet these challenges. In doing so, they have created a situation whereby they are now providing taxable air transportation service under sections 4261 and 4271.

Fractional aircraft ownership offers a tremendous amount of flexibility. Availability of an aircraft is guaranteed. There are no pre-set rules regarding advance notice requirements to obtain the use of an aircraft and last-minute, or even en route, travel changes are easily

accommodated.

The FAA has provided regulations governing fractional ownership programs under FAA part 91. Cite: FAA Regulations, part 91, subpart K, section 91.1001. The regulations impose training requirements, flight-and-duty time restrictions, maintenance requirements, and record-keeping obligations on fractional programs which are similar to those governing air charter operations. The difference between the FAA rules and regulations, and the federal excise tax laws, is that the FAA rules and regulations are geared toward ensuring the flying safety of the public, whereas the federal tax law is geared toward administering the excise tax laws.

The Fractional Aircraft Program

A Fractional Management Company offers prospective jet aircraft owners the ability to purchase a share of an aircraft. Fractional Management companies can operate and manage fleets as small as one or two aircraft up to hundreds of aircraft. These programs are best viewed as a means of obtaining a partial interest in a particular aircraft, combined with a mechanism for sharing in all of the aircraft the fractional management company operates. All operations are arranged and managed by the Program Manager who is part of the Fractional Management Company. This results in a very sophisticated system that offers first class travel.

When the aircraft in which the fractional owner has an interest is not available for the owner's use at a particular time, the Program Manager may provide a different aircraft from the Program Manager’s pool of aircraft. If an aircraft from the Program Manager’s aircraft pool is not available, generally, the Program Manager will obtain an aircraft from an outside source. The Program Manager is responsible for all of the services requiring aviation expertise, including pilot selection, crew training, aircraft maintenance, flight planning, flight dispatch, and scheduling. The Program Manager’s job is to ensure that operating and safety standards are met.

Usually, the Program Manager will initially own or lease the aircraft used in its program. The Program Manager will then sell undivided interests of a fraction of the aircraft to buyers. Fractional ownership begins with a one-sixteenth share of a jet aircraft. The one-sixteenth share of ownership typically entitles the purchaser to 50 hours of aircraft usage per year. Fractional ownership shares of a rotorcraft may be as small as one-thirty-second of the rotorcraft. In some situations, a parent or related company of the Program Manager will manufacture the aircraft and sell the fractional share of the aircraft to the prospective customers of the Program Manager.

Costs and Fees

Under a Fractional Program the same financial model for accounting for aircraft costs is generally used. Payments fall under four categories:

- The share acquisition cost,
- The aircraft management fee,
- An occupied hourly charge, and
- Other miscellaneous charges.

Share Acquisition Cost

The share acquisition cost reflects the purchase price of the shareowner‘s portion of the aircraft. For example, a quarter share owner will pay 25 percent of the price of the aircraft. The aircraft price, called the sticker price, could be at the wholesale, retail, retail-plus price, or anywhere in between. The Program Manger typically agrees to repurchase the fractional owner’s share at the end of the fractional ownership term for the fair market value of the

aircraft, less a remarketing fee.

Example:

An aircraft is offered for fractional ownership at the price of $ 4 million. A share of the aircraft is equal to 1/16th of the aircraft and is sold at the share acquisition cost of $ 250,000. If Corporation A purchases 4 shares, they will own 1/4th of the aircraft (4 shares times 1/16 per share equals ¼ of aircraft) and have a total share acquisition cost of $1 million (4 shares times $250,000 acquisition cost per share equals $1,000,000 total acquisition cost).

Aircraft Management Fee

The aircraft management fee is typically paid to the Program Manager on a monthly basis. The amount paid depends upon the type and cost of the aircraft owned along with the size and number of shares owned. The aircraft management fee is charged to cover fixed costs such as pilot and crew salaries, insurance, and other known scheduling costs. Since contract terms can last five years or more, most programs include fee increase clauses based upon a function of the Consumer Price Index (CPI).

Example:

Once Corporation A purchases its 4 shares of the aircraft, it contracts with the Program Manager to provide all services related to the aircraft. The Program Manager has determined that a fee of $1,000 per share will be charged monthly for the time under the program management contract. Therefore, Corporation A will pay $ 4,000 per month (4 shares times $1,000 per month) for the aircraft management fee for each month that it is under contract with the Program Manager for the aircraft services.

Occupied Hourly Rate

The occupied hourly rate is the amount paid for each hour of flight time used. The fuel consumed per hour of flight time and the required maintenance costs are the biggest contributors to the amount of the fee charged per hour. The fractional owners pay for the time the aircraft is used from takeoff to landing, with some programs adding time (typically 1/10 hour) before takeoff and after landing to compensate for time spent on the ground to taxi to and from the runway. Most programs have a minimum flight time of one hour. The occupied hourly rate is often increased on an annual basis computed based on a function of the Consumer Price Index (CPI). There is also a separate adjustment for the price of fuel should fuel costs change.

Example:

When flying their aircraft, Corporation A is charged an hourly usage of $ 4,500 per hour. In flying from Minneapolis, MN, to Los Angeles, CA, the plane was in the air for 3.5 hours. Per contract, an additional one-tenth (1/10th) of an hour is charged for taxiing to take-off and from landing. Therefore, for the flight noted, Corporation A is charged $ 16,650 (3.7 hours times $ 4,500 per hour).

Other Miscellaneous Charges

In addition to the above charges, there will be miscellaneous expenses charged with each flight which are specific to that particular flight. Examples of these types of charges include:

- Pilot costs for hotel and meals for layovers
- Airport landing fees
- Airport hangar fees or parking fees
- Catering charges

Each of these charges, as well as any additional charges, will be billed separately to the fractional aircraft owner, usually with the monthly aircraft management fee and the occupied hourly rate.

Taxability of Fees

In Executive Jet Aviation Inc. v. United States, the courts decided that a Fractional Program Manager was providing a taxable service under section 4261. The court did not address everything that could be considered part of the tax base. Cite: Executive Jet Aviation Inc. v. United States, 123 F.3d 1463 (1997 C.A. Fed), 80 A.F.T.R.2d 97-6502. What constitutes an "amount paid" for taxable transportation is discussed in Rev. Rul. 74-123. In computing the transportation tax, the "amount paid" to the Program Manager includes not only the money actually paid by the owners, but also the value of the use of the aircraft provided by the owner. Cite: Rev. Rul. 74-123, 1974-1 C.C. 318. Therefore, all amounts paid by the fractional aircraft owner to the Program Manager are considered to be taxable unless they are specifically exempted by the Code and separately stated to the fractional aircraft owner and in the records of the Program Manager. An example of such an expense is catering fees for meals provided during the flight.

Operative Agreements

Four key agreements, also known as operative agreements, form the foundation of most fractional programs. These agreements are entered into at the time that the aircraft fractional share is purchased. The agreements can be for a number of years or be renewed on an annual basis. In all cases, each agreement will have a clause which will allow the parties an ability to cancel the agreement early as long as a cancellation fee and proper notice is made to the other party.

Operative agreements include the following:

1. An Aircraft Purchase Agreement or dry lease agreement,
2. A Management Agreement with the Program Manager,
3. An Owners Agreement, with the other party or parties holding an interest in the same aircraft, and
4. A Master Interchange Agreement with other aircraft owners in the program.

Note: In some programs the Owners Agreement and Master Interchange Agreement may be one and the same.

Aircraft Purchase Agreement

Under an Aircraft Purchase Agreement, the purchaser receives a bill of sale conveying title for their fraction of a specific program aircraft. Although the purchaser is entitled to inspect the aircraft, they are not permitted to place their own insignia on either the interior or exterior of the aircraft. The purchaser also agrees not to sell or otherwise transfer its interest in the aircraft, except to an affiliate of the purchaser, without the consent of the Program Manager.

When a transfer is proposed, the Program Manager's consent is contingent upon the "new purchaser" assuming all of the original purchaser's obligations. The purchaser has the option to sell its aircraft interest back to the Program Manager, usually at a value which is noted in the aircraft purchase agreement. In addition, if the purchaser still retains its interest in the aircraft at the end of a period stated within the contract (for example, at the end of 5 years),

the Program Manager can initiate action to repurchase the purchaser's interest in the aircraft after providing a written notice to the purchaser. During the period that the Operative Agreements are in place, the purchaser is entitled to flight time on the aircraft in proportion to its fractional share in the aircraft.

Dry Leases

Although traditional Fractional Programs require the purchase of an interest in an aircraft, recent programs have evolved which allow purchasers to dry lease a fractional share of an aircraft. Under the dry lease, the aircraft is leased to the lessee by the ultimate owner of the aircraft, without a crew. The lessee then transfers possession, command, and control of the aircraft to the Program Manager who provides the pilot, crew, and other items necessary for operation of the aircraft.

Management Agreement

The second agreement to be signed by the parties is a Management Agreement. Under the Management Agreement, the Program Manager is appointed by the fractional owner to manage the fractional owner's share of their aircraft. In addition, the Program Manager assumes full responsibility for maintenance and operation of the aircraft. Specific services provided by the Program Manager include:

- Inspection, service, repair, overhaul, and testing the aircraft in order to maintain its airworthiness certification from the Federal Aviation Administration (FAA),
- Maintaining records, logs, and other materials required by the FAA with respect to the aircraft,
- Purchasing fuel,
- Payment of hangar and tie-down costs, landing fees, in-flight food and beverages, flight planning, weather contract services, and the salary and travel expenses of the crew.
- Providing a pool of professionally qualified pilots who are licensed to operate the aircraft.
- Obtaining and maintaining aircraft hull and liability insurance.

Each of the above expenses are incurred by the Program Manager at its own cost and expense and are passed on to the fractional owner through the monthly management fees, occupied hourly rate, or the other miscellaneous fees noted previously. In return for the program manager's services, the aircraft fractional owner agrees to make the aircraft in which they own or lease an interest available to other participants. In addition, the aircraft fractional owner agrees to pay the fees noted above in Costs and Fees.

Excise Tax Responsibility

Generally, the Management Agreement also spells out the responsibility of the payment of federal air transportation excise taxes. Under fractional ownership, the purchaser of the aircraft fraction contracts with the Program Manager to operate the aircraft and provide the pilots. Upon doing so, the possession, command, and control of the aircraft transfers to the Program Manager. Therefore, the Program Manager is responsible for collecting the taxes imposed by section 4261, remitting the tax to the Government, and filing the Form 720 to report the tax. The fractional purchaser is the true taxpayer and is responsible for paying the federal excise tax along with any additional amounts assessed at a later date.

Owner's Agreement

The third key document, the Owner's Agreement, allows for sharing of the aircraft between the fractional owners of that aircraft. The document serves as a contract between all owners of an individual serial-numbered aircraft. The Owners Agreement enumerates each fractional

owner's fractional ownership and notes that the relationship of the fractional owners with respect to the aircraft is that of tenants-in-common. Pursuant to the Owners Agreement, each Participant is required to place their aircraft into an Exchange Program which enables each Participant to have access to the aircraft on a first-come, first-served basis.

Master Interchange Agreement

In addition to the owner's agreement, the aircraft will be placed into the aircraft pool of the Program Manager. The placement of the aircraft into the pool is generally accomplished by the execution of a Master Interchange Agreement or a dry lease agreement.

The Master Interchange Agreement or dry lease agreement, herein referred to as the Master Interchange Agreement, executed by each fractional owner indicates that the fractional owners wish to have the Program Manager provide administrative services to enable the fractional owner to share their aircraft with other fractional owners. In addition, the fractional owner will be able to use any other aircraft in the Program Manager's aircraft pool. The Master Interchange Agreement provides that each fractional owner is entitled to the use of other aircraft on a first-come, first-served basis. The use of other aircraft in the program pool only occurs when the fractional owner is unable to use his own aircraft. No charge is levied against the fractional owner for using another aircraft in the pool unless the fractional owner requests a substitute aircraft that has a higher value than the fractional owner's aircraft.

Note: Although each of the agreements described above list specific items that may be contained within the agreement, it is imperative that the actual contracts for the specific Fractional Program be reviewed and analyzed to develop the relevant facts of the case.

Issue of Possession, Command, and Control

The issue of whether the owners have surrendered possession, command, and control of the aircraft to the fractional management company must be addressed. The nature of the rights surrendered by the fractional owner must be weighed against the nature of the rights retained by the fractional owner in order to determine whether the fractional management company is providing taxable transportation. Reference Taxability of Fees above for a discussion of the taxability of the various fees imposed in fractional ownership.

As a general matter, amounts paid for taxable transportation to an entity that has possession, command, and control of the aircraft are taxable under section 4261. The entity that controls the pilot of an aircraft, such as the lessor under a "wet lease" arrangement, has possession, command, and control of the aircraft. Cite: Rev. Rul. 60-311, 1960-2 C.B. 341.

Consistent with these concepts, Rev. Rul. 58-215 holds that a corporate aircraft owner, who contracted with an airline company for the operation and maintenance of the aircraft, but retained exclusive control over the aircraft crew, was not being provided taxable transportation by the airline company under section 4261. Cite: Rev. Rul. 58-215, 1958-1 C.B. 439. In contrast, Rev. Rul. 74-123 concludes that where an aviation company provided air transportation for a federal agency on aircraft owned by the agency, the service provided by the company when it used agency planes was essentially the same service provided by the company when it used its own aircraft. Thus, in both situations under Rev. Rul. 74-123, the company was providing taxable air transportation. Cite: Rev. Rul. 74-123, 1974-1 C.B. 318.

The conclusions in Rev. Rul. 58-215 and Rev. Rul. 74-123 are not inconsistent because they are based on different factual situations. Although in both rulings title to the aircraft remained with the entity whose personnel were being transported, the aircraft management company in Rev. Rul. 58-215 was acting as the aircraft owner's agent in the operation of the aircraft, and the owner had **exclusive** control of the pilots, maintained insurance, and paid the operating expenses of the aircraft. However, in Rev. Rul. 74-123, the aircraft management company

was acting as a principal in providing air transportation to the federal agency. The aircraft management company provided the aircraft crew and support personnel and was responsible under the contract for operations, maintenance, and insurance expenses. The provision of the air transportation service to the federal agency when the agency-owned aircraft were used was essentially the same as when company-owned aircraft were used.

Generally, fractional aircraft owners are required to purchase or lease undivided interests in an aircraft. The Operative Agreements executed at the time of purchase effectively allow the Program Manager to treat the program aircraft as part of a charter fleet. The Program Manager supplies the pilots for the aircraft and ensures they maintain the training necessary to pilot the aircraft; therefore, the Program Manager has command over the pilots. Even though, in some cases, the owners may designate which pilots they prefer, the Program Manager has ultimate control over assignment of crews.

In addition, the Program Manager is responsible for operations, maintenance, and insurance expenses of an aircraft. If an aircraft in which a fractional aircraft owner has an interest is not available for the fractional aircraft owner's use at a particular time, then under the Management Agreement and the Master Interchange Agreement, the Program Manager may provide another aircraft from the fractional program. If no aircraft is available from the fractional program, the Program Manager must provide the fractional aircraft owner with the use of a suitable and comparable replacement aircraft from another source. Because of the complexities with scheduling fractional aircraft owners on their own aircraft, it is not uncommon for a fractional aircraft owner to fly infrequently on its own aircraft.

Given all of the circumstances, including the preconditioned Operative Agreements and the respective responsibilities of the parties, the fractional aircraft owners, although title holders to their aircraft, have relinquished possession, command, and control of their respective aircraft to the Program Manager. Therefore, the Program Manager is providing taxable air transportation of persons under section 4261.

As a result, all amounts paid for taxable transportation to the Program Manager, by the fractional aircraft owners, must be included in the tax base for computing the taxes under section 4261. The amounts paid include the share acquisition cost, monthly aircraft management fee, the occupied hourly rate, and other miscellaneous charges. Rev. Rul. 60-311 held that the total payment for transportation service included not only cash payments but also payments in kind. Therefore, where a company receiving transportation service supplies the carrier with items that represent necessary elements of transportation, such as gas, oil, lubricants, equipment, or insurance, such items are considered to be payments for transportation. Cite: Rev. Rul. 60-311, 1960-2 C.B. 341..

Program Managers have argued that the fees paid by fractional aircraft owners are not costs of transporting persons for compensation or hire, but instead are defraying certain administrative costs and costs associated with aircraft ownership by the fractional aircraft owners. In some cases, the Program Manger is receiving the fees from the fractional aircraft owners as a principal that is providing air transportation for hire, and not as an agent of the owners. Compare Rev. Rul. 58-215, 1958-1 C.B. 439. The services provided by the Program Manager are directly related to the provision of air transportation; therefore, all amounts paid by the fractional aircraft owners to the Program Manager for the services are taxable.

Pursuant to section 49.4261-2(c) of the Facilities and Services Excise Taxes Regulations, charges for non-transportation services may be excluded in computing the tax payable. Accordingly, any portion of the fees paid to the Program Manager for the costs of meals, passenger use of telephone or facsimile services, and limousine or ground handling services, which are attributable to amounts paid for non-transportation services, may be excluded in computing the transportation tax, provided those amounts are separable from the amounts attributable to taxable transportation and the Program Manager's records show the exact amounts.

In conclusion, as provided in Rev. Rul. 74-123, when computing the transportation tax under section 4261, the "amount paid" includes all amounts paid by the fractional aircraft owners to the Program Manager. Non-transportation charges are excludable if they are separable from the amounts shown for air transportation and the Program Manager's records show the exact amount of the charge.

Examination Techniques

The following techniques are neither all-inclusive nor mandatory. Rather, they are suggested techniques to assist in an examination of a fractional management company. In looking at a filed Form 720, there is not a way to distinguish fractional management companies from other taxable air transporters. Therefore, the examination is to start with the steps noted below:

1. Review the Form 720. Determine the abstracts on which the tax is reported. For instance, if tax is reported only on abstract #026, be alert to the possibility that multiple abstracts are combined into one line entry on the Form 720;
2. Review the Form 720, Schedule C, for the types of fuel claims. Be aware to the possibility that fuel claims may be combined on one line;
3. Review Form 720, Schedule A, for the method of tax deposits used. It is not unusual for a taxpayer to report under the regular method when in fact they are using the alternative method. The alternative method is much simpler to use and normally the accounting systems can be set up to track the excise tax under that system. The regular method requires greater detail and many accounting systems are not set up to efficiently track the excise tax as it is collected. The regular method generally requires the taxpayer track collections on separate workpapers of some sort;
4. Perform an Internet search on the taxpayer to determine the kinds of services provided. Most charter and aircraft management companies have elaborate websites which describe the types of services provided in detail. In some cases, the amount of potential underpayment may be forecasted using the information provided on the website;
5. Go to the FAA.gov website and search for any aircraft the taxpayer may own along with the type of operator's certificates they may have;
6. Do a search on Accurint to secure basic information about the taxpayer.

During the initial contact, verify that the Taxpayer is a fractional management company. A list of questions which can be asked during the initial contact are noted below:

- Types of services offered.
  - For instance; do they offer international flights?
  - Do they offer transportation of property?
- Additional service offered.
  - Do they act as a management company for other nonfractional aircraft?
  - Do they have a fleet of aircraft that the fractional management company owns?
    - Are these aircraft chartered to customers?
- What type of certificate do the aircraft operate under? Usually, the fractional aircraft will operate under a Part 135 certificate or a Part 91 certificate.
  - How many aircraft operate under each type of certificate?

At this point an appointment letter and initial IDR can be prepared. The following items are to be requested to be available at the initial appointment:

1. Copies of any workpapers used to prepare the return.
2. A copy of the chart of accounts. The chart of accounts will provide clues into accounts that may be taxable but are being missed by the Program Manager.
3. A written narrative of how it accounts for and tracks FET along with the persons responsible for each function. In addition, a flow chart of the process from the time a ticket or charter is quoted and purchased to the report that shows the tax due can be

requested.
4. Obtain an explanation of how the program determines what charges are taxed and what charges are not taxed.
5. Obtain a sample of the reports which detail the various charges taxed.
6. Obtain copies of the operating flight documents.
7. Obtain a list of the fractional owners. This list should include the date each owner purchased or entered the program along with when each owner sold their interest or quit the program. The list should show the amount paid for each interest, the aircraft tail number, and the amount received for their interest at the end of the ownership term.
8. If the taxpayer is not collecting the excise tax on the management fees, obtain a list of owners who have paid the fees, the dates the fees were paid, along with the amount of fee paid.
9. Obtain an explanation of how the taxpayer accounts for all fuel purchased and used. How does the taxpayer determine the number of gallons of fuel that has been taxed and how do they determine the rate at which it is taxed? How did they determine the gallons of fuel used for foreign trade in addition to the number of gallons used for other tax-exempt purposes?

Commercial Airlines and Scheduled Flights

Introduction

Along with the activities of corporate and privately owned aircraft, regional and major airlines are in the business of transporting persons by air. These entities collect and remit the bulk of the reported transportation of persons by air excise taxes. Due to their size and volume of passenger traffic, major and regional airlines have issues which are unique to their operations.

Accounting for the Tax

The major commercial airlines compute the tax for air transportation using a network of computer terminals called a “computer reservations system.” Two such systems used by the airlines are the SABRE system and the APOLLO system. An individual carrier's sales accounting system merely extracts the passenger's tax liability from the “auditor's coupon” lifted from the carrier's ticket stock based on its individual recording procedures. Because airline tickets are usually sold in advance, the revenue, recognized at the time of the flight, does not coincide with the passenger's tax liability, which is recorded when the ticket is purchased.

Ticket Coding

In order to track taxes imposed on customers, airlines use tax codes which are noted on the receipt for the airline purchase provided to the customer. The tax codes used are as follows:

Code	Explanation
US	7.5% domestic tax or international departure and arrival fees. Also includes the 7.5% domestic tax and the international departure and arrival fees imposed on flights to and from Alaska and Hawaii.
ZP	US flight segment tax
XT	Combined taxes/user fees – this code is used when the number of taxes collected exceeds the number of tax boxes on the ticket. A breakdown of the taxes and user fees are to be shown in the fare calculation area of the ticket.

	Other Non-tax Codes
YC	US Customs Fee: $5.00 for tickets issued before April 1, 2007. $5.50 for tickets issued on or after April 1, 2007
XY	Immigration Fee: $7.00 for travel from an international point into the US or its possessions.
XA	Agricultural Inspection Fee
XF	Passenger Facility Charges
AY	US Security Service Fee

Ticket Stock

An airline which issues its own tickets is said to issue its own "ticket stock". In the case of a regional or feeder airline, a determination of who maintains the ticket stock and issues the tickets is important. Regional and feeder airlines that are fully controlled by a major airline will have their tickets issued through the major airline's ticket stock. Therefore, the major airline will be responsible for collecting and remitting the section 4261 taxes. The regional airline will not have this responsibility and will not have a reporting history for air transportation excise taxes.

Inter-Airline Operations

Carriers operate under two primary "interline agreements," which cover passenger ticketing, cargo, and baggage procedures. Interline agreements specify the source of accepted published fares and describe the process of settling funds between participating airlines. Interline agreements are established in order to simplify the ticketing process and minimize the number of tickets necessary to complete an itinerary that involves more than one air carrier.

Settlement between the carriers for revenue earned is either processed (1) through an "interline clearinghouse," such as the Airline Reporting Corporation (ARC), or (2) directly between the involved parties for providing travel services on tickets sold by other carriers. Currently, airlines do not "interline settle" U.S. taxes. The liability for air transportation tax is normally recorded by each individual carrier's accounting system. Carriers remit the transportation tax on the basis of their ticket stock sales. If a ticket is used on another airline, that airline bills the selling airline for only the fare, not the air transportation tax.

Discounted and Free Fares

Airlines offer free air transportation tickets to their employees as a part of the employee's benefits. Discounted fares offered to airline employees are subject to the applicable taxes under section 4261 or 4271 for any amount paid. If no amount is paid by the employee for the ticket, then no tax is imposed under section 4261 or 4271.

Ticket Refunds

Every person who refunds any amount with respect to a ticket or order that was purchased without payment of the air transportation tax must deduct from the amount refundable, to the extent available, any tax due as a result of the use of a portion of the transportation purchased in connection with the ticket or order and must report the amount of any remaining uncollected tax to the IRS. Cite: IRC § 4263(b).

If a passenger cancels his ticket, Rev. Rul. 89-109, 1989-2 C.B. 232 holds that to the extent

an airline refunded to a passenger the amount paid for air transportation, the collected transportation tax attributable to the amount of the refund should also be refunded to the passenger. However, to the extent that the airline did not refund the amount paid for air transportation to the passenger, the collected transportation tax attributable to the nonrefunded amount should have been remitted by the airline to the IRS. The same result would apply to a situation in which a carrier allowed the passenger a refund by credit rather than by cash, or if an airline offered a discount fare program under which it refunded less than the full purchase price in the event of cancellation of the ticket by the customer. But see United Airlines, Inc. v. U.S., 929 F.Supp. 1122 (N.D.Ill. Jun 27, 1996), aff'd 111 F.3d 551 (7th Cir.1997) (criticizing Rev. Rul. 89-109 and concluding that amounts retained by the airline as penalties or service charges for canceled tickets are amounts paid for taxable transportation).

Frequent Flyer Miles

The percentage tax applies to any amount paid to an air carrier or related person, whether in cash or in kind, for the right to award free or reduced rate air transportation. Cite: IRC § 4261 (e)(3). An example of this type of transaction is when a credit card company purchases miles from a carrier for the right to award the frequent flyer miles to its customers as a premium.

Examples of taxable amounts include:

- Payments for frequent flyer miles purchased by credit card companies, telephone companies, rental car companies, television networks, restaurants and hotels, and other businesses for distribution to their customers and others; and
- Amounts received by airlines pursuant to joint venture credit card or other marketing arrangements. Cite: Conference Committee Report on P.L. 105-34.

The percentage tax is computed based on the gross amount paid for the frequent flyer miles. No bifurcation or division of the amounts paid between the frequent flyer miles and costs such as marketing is allowed. Should an issue concerning the bifurcation, or division, of frequent flyer mile purchases occur, please contact the Air Transportation EIS or the Policy Analyst assigned to Air Transportation Taxes for assistance.

The rules for applying the section 4261(a) tax under section 4261(e)(3) to amounts paid for the right to provide mileage awards are set out in Notice 2002-63, 2002-2 C.B. 644:

1. Amounts paid for mileage awards that cannot be redeemed for taxable transportation beginning and ending in the United States are not subject to tax. For purposes of this rule, mileage awards issued by a foreign air carrier are considered to be usable only on that foreign air carrier and thus not redeemable for taxable transportation beginning and ending in the United States. Therefore, amounts paid to a foreign air carrier for mileage awards are not subject to tax.
2. Amounts paid by an air carrier to a domestic air carrier for mileage awards that can be redeemed for taxable transportation are not subject to tax to the extent those miles will be awarded in connection with the purchase of taxable transportation.
3. Amounts paid by an air carrier to a domestic air carrier for mileage awards that can be redeemed for taxable transportation are subject to tax to the extent those miles will not be awarded in connection with the purchase of taxable transportation.

Rev. Rul. 2002-60, 2002-2 C.B. 641, addresses the application of section 4261(e)(3) to exchanges of mileage awards between a foreign air carrier (Z) and a domestic air carrier. Under Rev. Rul. 2002-60, the value of the mileage awards transferred by Z is subject to tax, because none of the mileage awards will be provided to Z's customers in connection with the purchase of taxable transportation. Cites: Notice 2002-63, 2002-2 C.B. 644; Rev. Rul. 2002-60, 2002-2 C.B. 641.

Air Carrier Liability

Although air carriers are responsible for collection and remitting commercial air transportation taxes, liability for the tax is imposed on passengers. However, if the person paying for the taxable air transportation fails to pay the tax for any reason, the liability for the applicable section 4261 taxes is imposed on the air carrier providing the initial segment of air transportation which begins or ends in the United States. Cite: IRC § 4263(c). Note: Air carrier liability does not apply to the tax on amounts collected for the transportation of property under section 4271.

Potential Issues

The activities of major and regional airlines create the potential for issues that are the same as other air transportation providers and ones that are unique to the industry. Potential issues with major and regional airlines include:

- Adjustments under Part III of the Form 720 may contain credits for excise tax that was not refunded to the customer per IRC § 6415.
- Passenger tickets may not include all taxable items for computing the excise tax; in other words, certain charges may have been excluded from the tax base.
- Barter transactions with sports organizations, etc., may be structured so that no tax is collected.
- Amounts paid by credit card companies, banks, etc., for the right to award free or reduced-price air transportation (frequent flyer miles) are subject to excise tax.
- Excise tax may not have been charged on Government or military contracts.
- Ticket upgrades or exchanges may not include the additional tax.

Examination Techniques

The following list of examination techniques is designed to assist the field examiner in working a regional or major airline.

- In examinations of large companies, note that most are publicly held and issue annual reports to their stockholders. Reviewing these reports for 1 or more years will provide important information about the taxpayers.
- Review the Securities and Exchange Commission form 10K (annual report and related documentation) if the form is required to be filed.
- Review newsletters issued by large companies. These newsletters are valuable tools for learning about changes in company functions and everyday business practices. Large companies may also produce trade magazines or other publications.
- Interview tax managers and individuals who deal with the daily operations of the aircraft, such as chief pilots, maintenance personnel and scheduling agents, when appropriate. In Coordinated Examination cases, who you can interview may be limited and will need to be cleared through the Income Tax Case Coordinator. Ensure all disclosure rules are followed.
- Review historical examination information for income and excise tax issues. Review the number of aircraft, related entities and both the income tax and excise tax files for excise tax issues other than air transportation.
- Review the ARC's Industry Agent's Handbook, which details ticketing procedures, including refunds and exchanges.
- Take a tour of the airline ticket accounting department and discuss procedures and coding with those responsible for accounting for the information.
- Request consolidated workpapers used to prepare Form 720. Reconcile the total passenger transportation tax collected per book to the tax on the Form 720 to verify that all tax collected has been remitted. Explain discrepancies.
- Reconcile adjustment items on Form 720 to verify that the airline is entitled to the adjustment. Review corresponding accounts for blind credits.
- Review the general ledger and question the nontaxed revenue accounts to verify that the accounts do not contain taxable passenger revenue.
- Review liability accounts, paying attention to all sources of tax, especially any unusual debits to the account. Reconcile the liability at the end of the last quarter to ensure

that the accrued liability is correct.

- Review any charter or tour operation of the airline to verify that the tax calculated is correct.
- Review a sampling of tickets issued under various taxable situations using the ARC Industry Agent's Handbook to verify that the tax was calculated correctly per ticket. (Request a current copy of the handbook from the airline.)
- Verify that exemptions were not granted to state and local governments, the United States and its possessions, diplomats, or nonprofit educational organizations.
- Sample revenue accounts by analyzing lifted tickets, refunds, exchanges, upgrades, etc. to verify that the applicable excise tax has been collected.
- Airlines may make tax deposits based on amounts considered as collected (the "alternative method") under Excise Tax Procedural Regulations § 40.6302(c)-3, and make adjustments the next month. Verify that the correct adjustment has been made and determine that the amounts considered as collected are accurate.
- Review all refund claims (Form 8849, or Form 843, Claim for Refund and Request for Abatement; and Form 4136). Request supporting workpapers and verify that each claim is allowable.
- Request supporting workpapers for adjustments under Part III of the Form 720 for alternative method taxpayers.

Travel Agencies and Tour Operators

Introduction

One of the more interesting yet commonly misunderstood areas of air transportation deals with the applicability of the transportation of persons by air excise tax to the tour and travel industry. This chapter details various types of tour operations, describes the relationship between the operator and the travel agent, and provides guidance on determining which party is responsible for the collection and remittance of the excise tax to the Government.

Travel Agencies

A travel agency generally enters into contracts for travel services from suppliers such as airlines, hotels, car rental companies, and cruise lines. Travel agencies are also customers of tour operators since they purchase tour packages for resale to the general public.

When selling taxable transportation, a travel agency is acting either as a principal or as an agent for the airline company. When independent travel agencies sell tours to be taken on aircraft chartered from a carrier, the travel agencies are acting as principals and are required to collect the transportation tax, file returns, and pay over the tax to the Government. However, when travel agencies sell taxable tours as representatives of the airlines, they are acting as agents of the airlines. As agents, they are required to collect the transportation tax and remit the tax to the airlines. The airlines, in turn, are required to file returns and pay over the tax to the Government. This agency-versus-independent-broker distinction is based on a number of factors such as the exercise of possession, command, and control over the aircraft. Typically, travel agencies operate at the retail level, the wholesale level, or both. Cite: Rev. Rul. 75-296, 1975-2 C.B. 440.

Retail Travel Agencies

Retail agencies sell services directly to the consumer. Retail agencies are commissioned middlemen for numerous suppliers of travel services. Most agencies provide information and reservations services at no charge to the customer, but in some locales, retail agencies are considering a fee structure for these services. The "consumer" is often thought of as an individual seeking transportation services or a tour booking. For many agencies, however, the more important "consumer" may be the business accounts. The income reported on the agency's tax return does not indicate the relative importance of the business accounts, but to the excise tax examiner, it provides valuable information about the point of collection of

excise tax.

Wholesale Travel Agencies

Wholesale agencies primarily assemble and sell “packages” of services, such as air and land arrangements to Alaska or Hawaii. Although some wholesale agencies specialize in only one type of service, such as air passage to South America, they do not usually provide these services themselves; rather, they secure them from suppliers. The consumer is the individual traveler, and the traveler must normally purchase the package through a retail agency. A wholesale agency earns its income by securing blocks of reservations and reselling them at a markup. Suppliers deal with wholesalers instead of selling only to the public directly because wholesalers generate advance sales to the suppliers.

Tour Operators

In general, tour operators are entities that package or market inclusive vacation tours and sells them either through travel agents or directly to the public. Tour operators deliver the services specified in a given, advertised package. They may provide these services themselves by leasing planes, buses, hotels, or other facilities. On the other hand, they may obtain the services from suppliers, such as unrelated hotels, airlines, or car rental companies. In some cases, their offerings are marketed directly to the general public. In other cases, they are designed to the specifications of a wholesale travel agency that sells the packages under the agency's name. A tour operator profits from selling its package for amounts greater than its cost.

The majority of tour operators are small air carriers and airlines who are categorized by the FAA as Part 135 carriers, registered for on-demand air taxi services. These operators assemble tour packages that combine air transportation as well as non-air transportation components. The total package includes the air flight, lodging, meals, ground transportation, baggage handling, and any other fees, options, and services that are charged to the customers.

When selling the tour packages directly to the public, the tour operator has the responsibility for the collection and remittance of the air transportation excise tax. The operator must maintain adequate records in order to determine the basis upon which to apply the section 4261(a) tax. In other words, a distinction in the books and records is required to split the taxable air transportation component from the nontaxable, non-air transportation components. Facilities and Services Excise Taxes Reg. § 49.4261-2(c) provides:

> If the charges for nontransportation services are not separable and are not shown in the exact amounts thereof in the records pertaining to the charges for transportation of the person, the tax must be computed upon the full amount of the payment.

Items which are considered to be non-air transportation components are:

- Ground transportation;
- Baggage handling, storage, and transfer;
- Charges for admissions,
- Charges for tour guides,
- Charges for non-flight meals and meal plans,
- Hotel accommodations, and
- Other non-air transportation services.

Cite: Facilities and Services Excise Taxes Reg. § 49.4261-7; examples of payments subject to tax. Facilities and Services Excise Taxes Reg. § 49.4261-8; examples of payments not subject to tax.

Taxability of Tour Costs

Amounts paid are taxable with respect to the portion that represents the air transportation of persons. The Service is not bound to accept the characterization of an amount allocated to something other than air transportation. This is especially true in the case of amounts paid as part of a package tour. For example, when an amount is paid for a travel package which includes travel to a casino, hotel accommodations, and ground transportation, the Service required a reallocation of the amounts paid between the amount paid for the taxable transportation and the amount paid for the nontaxable items. The reallocation was based on each item's respective fair market value. The reallocation occurred even though the casino's advertising claimed that the air transportation was free. Cite: Rev. Rul. 63-155, 1963-2 C.B. 566.

It is important to review records for changes to ensure that values assigned to nontaxable transportation are not higher than their actual value. If the values are too high, they have the effect of minimizing the base on which the section 4261(a) excise tax is computed. For example, when a total tour package price is $100, a taxpayer may insist that the non-air transportation charges are $75 when they are really $50. This results in a taxable base of $25 instead of $50. The taxpayer is to provide adequate substantiation and valuations for the non-air transportation charges. Cite: Cross v. United States, 311 F.2d 90 (4th Cir. 1962); 63-1 U.S.T.C. 15,466; and White House Sightseeing Corp. v. United States, 300 F.2d 449 (Ct.Cl. 1962); 62-1 U.S.T.C. 15,395 (cases involving the former tax on transportation by bus; the analysis for substantiation and valuation still applies to the tax on transportation by air). If the charges for nontransportation services are not separable from the charge for air transportation of the person, the tax must be computed upon the full amount of the payment. Cite: Facilities and Services Excise Taxes Reg. § 49.4261-2(c). The person or entity paying for taxable air transportation is liable for the transportation tax, but the person receiving the payment must collect the tax and file the return. Cite: IRC § 4291.

"Free" Air Transportation Tours

When a tour operator/air carrier sells tour packages or junkets to the public, the tour price is a set figure with no breakdown for air transportation and non-air transportation charges. One flat fee that purportedly covers all charges is charged. In Las Vegas Hacienda, Inc. v. Civil Aeronautics Board, 298 F.2d 430 (9th Cir. 1962), cert. denied 369 U.S. 885 (1962), the court upheld a federal agency decision that a resort hotel operator selling package tours, including "free" airplane rides on its aircraft, was a common carrier for compensation or hire. On these facts, in Rev. Rul. 63-155, 1963-2 C.B. 566, the Service determined that the amounts paid by hotel customers for the "free" air transportation package tours included a charge for taxable transportation. Thus, the portion of the amount paid for the tours that was reasonably attributable to the transportation service was subject to the transportation tax. The revenue ruling outlines a formula used to arrive at the tax base on which to calculate the excise tax.

Further, Rev. Rul. 72-585, 1972-2 C.B. 578 states that, if a single amount is paid for air transportation of a mixed load of persons and property, tax must be paid (1) under section 4261 on the part of the payment that represents the amount charged for transportation of persons and (2) under section 4271 for the payment representing transportation of property. An allocation of the single charge must be made on a fair and reasonable basis and must be supportable by adequate records.

Small Aircraft under 6,000 Pounds; Operated on an Established Line

IRC § 4281 provides that the taxes imposed by section 4261 shall not apply to transportation by an aircraft having a maximum certificated takeoff weight of 6,000 pounds or less, except when such aircraft is operated on an established line. For flights paid for and beginning after September 30, 2005, note that if the sole purpose of the flight is sightseeing, then the flight is by definition not operated on an established line.

A common mistake made by tour operators who use their own airplanes to fly tour passengers is that they claim to be exempt from the excise tax because they operate small aircraft with a certificated weight of 6,000 pounds or less. This misconception stems from their interpretation of the Federal Aviation Administration Regulations, Part 135, which categorizes these small aircraft as "on demand air taxi services, not operated on a specific SCHEDULE." However, most do maintain somewhat of a schedule since they want to maximize the aircraft usage. These operators run, for example, morning and afternoon trips and set approximate times for departures. The issue in these cases is whether the carriers operate on an established line. The determination of whether an aircraft is operating on an established line is based on the facts and circumstances, using such criteria as regularity and frequency of flights.

Section 49.4263-5(c) of the Facilities and Services Excise Taxes Regulations defines the term "operated on an established line" to mean operated with some degree of regularity between definite points. Further, that term does not necessarily mean that strict regularity of schedule is maintained; that the full run is always made; that a particular route is followed, or that intermediate stops are restricted. The term implies that the person rendering the service maintains and exercises control over the direction, route, time, number of passengers carried, etc.

Section 49.4263-5(a) of the Regulations generally provides that the section 4281 exemption applies to amounts paid for the transportation of persons on a small aircraft of the type sometimes referred to as "air taxis." Although the term "air taxis" is not defined in the regulations, it is described in Lake Mead Air, Inc. v. United States, 991 F. Supp. 1209, 1212 (D.Nev. 1997), as "an airplane for hire, subject to the whims of a particular customer. Except to the hiring customer, its route is wholly unpredictable and unreliable."

In Rev. Rul. 66-301, 1966-2 C.B. 475, the operator of a helicopter offered rides on a walk-up basis at a community fair. There were no scheduled or fixed times of departure and no advance bookings or reservations were available. The existence of the rides was contingent upon the fair that lasted only a few days a year. Reasoning that a schedule other than customer demands is necessary to be conducted with "some degree of regularity," the revenue ruling concluded that a sporadic operation like the community fair helicopter rides was not operated on an established line.

In Rev. Rul. 72-617, 1972-2 C.B. 580, an air taxi carrier entered into a contract with the United States Postal Service to provide overnight air mail service between two cities. Before entering into the contract, the carrier did not fly to these cities. The contract provided for exclusive use of the aircraft for six regularly scheduled round trips weekly between certain overnight hours to meet postal requirements for an overnight exchange of mail. Although the flights met the "some degree of regularity" requirement of the regulations, the revenue ruling concluded that the aircraft making the flights was not operated on an established line because the carrier did not retain control over the direction, route, time, or cargo carried.

In Rev. Rul. 72-219, 1972-1, C.B. 350, air carrier operated both scheduled and unscheduled flights between the same destinations. Viewed together, the Service concluded that the activity was conducted 'with some degree of regularity between definite points,' and that the airline, in rendering the extra flights between these two points, 'maintains and exercises control over the direction, route, time, number of passengers carried. etc.' Thus, all flights were taxable.

Relationship Between the Entities

The functions of the above entities are not sharply separate or mutually exclusive. Although some entities operate strictly as retail agencies or as wholesalers, it is not unusual to find others who have both features within their operations. Along with selling a full range of retail services, some agencies wholesale unusual vacation packages they have assembled. In such cases, an individual who wants to book a vacation package has to make the booking

through a travel agency.

Accordingly, a tour operator can also function as a wholesaler. An example is a company that offers bus tours of selected areas of the United States. Its primary operation is conducting tours. For some portions of those tours, it uses its own facilities; for other portions, it enters into contracts with suppliers. In this capacity, it is a tour operator. It is also a wholesaler to the extent that it markets its tours through retail agencies.

Internet Intermediaries

With the advent of the internet, a new type of agency has developed in the sale of airline tickets. When the ultimate customer would like to purchase an airline ticket at the lowest possible price, the customer logs onto the internet intermediary's web site and enters information on the location and date a flight is needed. The internet intermediary contacts the airlines and receives price quotes for itineraries. This information is then passed on to the customer without identifying the specific air carrier. The customer then decides whether or not to accept a quote. Upon the acceptance of a quote by the customer, the internet intermediary purchases the ticket from the airline in the customer's name and forwards it electronically to the ultimate customer. The internet intermediary is not related to the airline or under the airline's supervision or control.

In order for the internet intermediary to make a profit, a fee is added to the initial ticket price quoted by the airline to the internet reseller. Even though the ultimate purchaser pays a higher amount to the internet intermediary, the amount of the section 4261 tax is computed on the amount paid by the internet intermediary to the airline. In this case, the internet intermediary is acting as a conduit for the ultimate purchaser and the additional fee paid is for the intermediary's services, not a fee for the purchase of air transportation. The airline selling the ticket is responsible for collecting and remitting the tax on the sale of the ticket. Cite: Rev. Rul. 2006-52, 2006-43 I.R.B. 761.

Foreign Based Travel Agencies

There are a number of foreign-based travel agencies acting as principals that sell package tours to vacation destinations in the United States. Payment for the air transportation is made outside the United States. If the payment is for air transportation of persons that begins and ends in the United States, sections 4261(a) and (b) apply. If the payment is for air transportation of persons that begins or ends in the United States, section 4261(c)(1) applies. In this case, the foreign based travel agency is responsible for collecting and remitting the applicable taxes to the United States Government. Given that these travel agencies are located in a foreign country, there is difficulty in obtaining books and records, ensuring that the tax is properly collected, and securing payment.

Another issue concerns domestic tour operators who team with foreign based travel agencies and sell a "sightseeing trip" by air to a national park or other attraction to be included in the overall tour. The domestic tour operator may not collect the excise tax on this segment of the flight, arguing that the total flight is uninterrupted international air travel that begins and ends outside the United States. This depends on the timing of the flight pattern. Determine whether the sightseeing destinations are part of an uninterrupted international flight or are merely "side trips." Additionally, after September 30, 2005, it must be determined if the sightseeing tour takes place on an aircraft with a certificated weight of 6,000 pounds or less, in which case, the flight probably meets the section 4281 exemption. Reference Uninterrupted International Air Transportation in Chapter 1, Air Transportation of Persons for a discussion of uninterrupted international flights.

Examination Techniques

The most valuable and complete information gathered on an examination comes from an interview with the taxpayer. A tour of the taxpayer's facility and a discussion of the taxpayer's

books and accounts used to record transactions, to see how daily business is conducted, is also important. However, reviewing and inspecting the taxpayer's in-house books and records provides only a portion of the data needed for an audit. Pilots' log books, flight charts, and information required by the local airport authority, such as passenger counts, are informative. Airport Authorities, which are also required to provide information to the FAA and the U.S. Department of Transportation, are also good sources of data on the volume of operations of the taxpayer.

In addition to the sales, income, and expense information obtained from the taxpayer's books, a review of the following data and documentation discussed below is necessary:

- Review the operation of the company to determine the types of services furnished, the types of aircraft used, the areas covered, the records kept, the services the taxpayer considers taxable and not taxable, the method by which the tax is computed, and other information as appropriate.
- Review the records looking for untaxed revenue, including records on untaxed flights as well as the details of items not taxed on charter flights. Ensure that the untaxed charges are, in fact, properly described.
- The air carrier prepares a list of passengers on each flight in case of an accident. Request these manifests to compare the number of passengers flown with the number of passengers reported for the excise tax computation.
- Pilots keep a log for each flight. Review the pilot logs for owned or leased aircraft to ensure all flights are accounted for.
- Review a copy of the charter or lease agreement(s) when applicable. Such documents often spell out the arrangements for the collection and payment of taxes.
- Whenever possible, secure brochures and pamphlets from the taxpayer's flight terminal/facility. Some companies also maintain websites. Review to ensure all services are accounted for.
- Contact the travel agencies that air carriers use as sources of customers. Also, see if the air carrier uses any large commercial bus services as a source of customer counts.
- Since many air carriers use vouchers in lieu of tickets, secure the vouchers to determine the passenger counts.
- Determine the basis on which the excise tax was collected from the passengers. Some air carriers and travel agents have charged the air transportation tax on the total tour package price.
- Contact the local airport authority to get the figures on the passenger facility charge, if applicable.
- Review the aircraft maintenance logs to determine the flight hours and the frequency of trips.

Alaska and Hawaii

Introduction

In order to fly to the states of Alaska and Hawaii, flight patterns must cross international waters and/or foreign countries. Flights to Alaska and Hawaii are neither fully domestic flights nor international flights. As a result, the percentage tax, the domestic segment tax, and the international travel facilities tax are all imposed on amounts paid for this transportation. However, there are special rules for calculating the percentage tax and a reduced-rate international travel facilities tax. This chapter will discuss the special rules and provide resource information as to the tax rates to be used in computing the amount of excise tax due.

Percentage Tax

Flights between the continental United States and Alaska or Hawaii must be apportioned between the portion that occurs over the United States and the portion of the flight that occurs

outside of the United States. The same apportionment must also be performed for flights between Alaska and Hawaii. The percentage of the flight which occurs over the United States or its territorial waters is used to determine the amount upon which the percentage tax is imposed. Cite: Rev. Rul. 75-166, 1975-1 C.B. 352. In order to correctly determine the amount paid subject to percentage tax, the arrival/departure location within the continental United States and the departure/arrival location in Alaska and Hawaii must be known.

Calculating the Amount Subject to the Percentage Tax

Taxable transportation to and from Alaska and Hawaii does not include transportation which meets all four of the following:

1. The portion is outside the United States;
2. Neither the portion nor any segment thereof is directly or indirectly (A) between (i) a point where the rout of the transportation leaves or enters the continental Untied States, or (ii) a port or station in the 225-mile zone, and (B) a port or station in the 225-mile zone;
3. Such portion (A) begins at either (i) the point where the route of the transportation leaves the United States, or (ii) a port or station in the 225-mile zone, and (B) ends at either (i) the point where the route of the transportation enters the United States, or (ii) a port or station in the 225-mile zone; and
4. A direct line from the point (or the port or station specified in paragraph (3)(A), to the point (or the port or station) specified in paragraph (3)(B), passes through or over a point which is not within 225 miles of the United States.

Cite: IRC § 4262(b).

Transportation is generally considered to leave or enter the United States when the route of the transportation passes over either the U.S. border (if traveling into a contiguous foreign country) or a point 3 nautical miles (3.45 statute miles) from low tide on the coast line. Cite: Facilities and Services Excise Taxes Reg. § 49.4262(b)-1(a).

Under the provisions of section 4262(b) transportation between the continental United States or the 225-mile zone and Alaska or Hawaii will be partially exempt from the tax. The portion of such transportation which (i) is outside the United States, (ii) is not transportation between ports or stations within the continental United States or the 225-mile zone, and (iii) is not transportation between ports or stations within Alaska or Hawaii, meets all the requirements set forth in section 4262(b) and is excluded from taxable transportation. Cite: Facilities and Services Excise Taxes Reg. § 49.4262(b)-1(b).

Examples:

Example (1). A buys a ticket for transportation by air from Seattle to Fairbanks, Alaska, via Ketchikan and Juneau, Alaska, and Whitehorse, Yukon Territory, Canada. The portion of the transportation between the point where the route of the transportation leaves the continental United States and the point where it first enters Alaska (the three-mile limit or the international boundary) is not subject to tax.

Example (2). B purchased a ticket for transportation by air from Chicago to Juneau, Alaska, by way of Vancouver, Canada. The portion of the transportation from Vancouver to the point where the route of the transportation enters the three-mile limit off the coast of Alaska is not subject to tax.

Example (3). C purchases a ticket in the United States for transportation by air from Vancouver, Canada, to Honolulu, Hawaii. No part of the route followed by

the carrier passes through or over any part of the continental United States. The only part of the payment made by C for this transportation which is subject to the tax is that applicable to the portion of the transportation between the three-mile limit off the coast of Hawaii and the airport in Honolulu.

Cite: Facilities and Services Excise Taxes Reg. § 49.4262(b)-1(b).

Transportation within Alaska or within Hawaii

For air transportation between stations within Alaska or between stations within Hawaii, the regular percentage tax rate imposed under section 4261(a) applies. There is no apportionment of the percentage tax as no portion of the flights meets the exclusions set forth under section 4262(b).

Domestic Segment Tax

The domestic segment tax is imposed on all segments to and from as well as within Hawaii and Alaska. The tax rate is the full, unapportioned domestic segment tax rate in effect at the time of the payment of the flight. (However, there is an exception to the domestic segment tax under section 4261(e)(1) for segments to and from rural airports. A number of airports in Hawaii and Alaska meet the definition of rural airport. Thus, the domestic segment may not apply. See the discussion of Rural Airports in Chapter 1, Air Transportation of Persons.)

Example:

In 2007, passenger A pays $5,000 to fly from Minneapolis, MN, to Honolulu, HI. A segment tax of $6.80 ($3.40 times 2 segments, one from Minneapolis to Honolulu and one from Honolulu to Minneapolis) is imposed on the round trip ticket.

International Facilities Tax

Along with the section 4261(a) percentage tax and 4261(b) segment tax, the section 4261(c)(3) international facilities tax is imposed because the aircraft travels over international waters and/or the land of another country. (Note that section 4261(c)(2) provides an exception for transportation entirely taxable under section 4261(a). Because amounts paid for flights to and from Alaska and Hawaii are not entirely taxable under section 4261(a), that exception does not apply.) Thus, the international facilities tax is modified to reflect a specific Alaska and Hawaii rate. The tax applies to departures only.

Table of International Facilities Tax for Alaska and Hawaii

Tax Period	Alaska and Hawaii
During 2003	$ 6.70
During 2004	$ 6.90
During 2005	$ 7.00
During 2006	$ 7.30
During 2007	$ 7.50
During 2008	$ 7.70

Example:

Continuing the example above, Passenger A would also be responsible for paying $7.50 of international facilities taxes for the departure beginning in Minneapolis, MN, and ending in Honolulu, HI.

Transportation of Property by Air

Introduction

As with transportation of persons by air, the amount paid for transportation of property by air is subject to excise tax. The excise tax collected on the amount paid for the taxable transportation of property by air is also deposited into the Airport and Airway Trust Fund. This fund is used to improve and maintain the nation's airports and airways.

Transportation of Property Tax

IRC § 4271 imposes a tax at a rate of 6.25 percent on the amount paid for taxable transportation of property by air. This tax is imposed on the "amounts paid" to a person engaged in the business of transporting property by air. As in the taxable transportation of persons, the taxpayer is the entity paying for the transportation of property and the collector/return filer is generally the entity receiving the payment for the transportation.

Transportation must be within the United States

Unlike the tax on the transportation of persons, the transportation of property by air excise tax is imposed only on amounts paid to transport property within the United States and its boundaries. Under IRC § 4272(a), the term "taxable transportation" means transportation by air which begins and ends in the United States. Air transportation of property which begins or ends outside of the United States or within the 225-mile zone is not taxable.

Example:

Company A signs a contract with Air Transporter C to fly Company A's property from Chicago, IL, to Winnipeg, Canada. Since the destination of the air transportation is outside of the United States, the section 4271 tax does not apply even though it is transported to a location within 225 miles of the U. S.

Shipments to and from Alaska and Hawaii

Although the tax on transportation of property by air applies to the amount paid for shipments between the continental United States and Alaska or Hawaii, it will not apply to the portion of the payment allocable to the transportation which is not over the United States (i.e. the amount of the transportation over international waters or a foreign country). IRC § 4272(a) provides that the term "taxable transportation" does not include the portion of transportation which meets the requirements of paragraphs (1), (2), (3), and (4) of section 4262(b). In other words, the amount paid for the portion of the transportation where:

1. such portion is outside of the United States,
2. neither such portion nor any segment thereof is directly or indirectly-
    A. between (i) a point where the route of the transportation leaves or enters the continental United States, or (ii) a port or station in the 225-mile zone, and (B) a port or station in the 225-mile zone;
3. such portion-
    A. begins at either (i) the point where the route of the transportation leaves the United States, or (ii) a port or station in the 225-mile zone, and (B) ends at

either (i) the point where the route of the transportation enters the United States, or (ii) a port or station in the 225-mile zone; and

4. a direct line from the point (or the port or station) specified in paragraph (3)(A), to the point (or the port or station) specified in paragraph (3)(B), passes through or over a point which is not within 225 miles of the United States

is not an amount paid for "taxable transportation of property" and tax is not due.

In contrast, the transportation of property by air tax applies to flights between ports or stations in Alaska and the Aleutian Islands, as well as between ports or stations in Hawaii, even though a portion of the flight is over international waters or over Canada. This is because no point on these flights is more than 225 miles from the U.S., and thus no portion of these flights can meet the requirements stated in section 4262(b).

It is also important to point out another exception which may come into play for flights between the continental United States and Alaska. When a flight to Alaska involves a stopover in Canada within the 225-mile zone, only the portion of the flight from the stopover point to the Alaskan border can be excluded from the application of the tax. This is contrary to the general rule that would exclude all transportation from the Canada/U.S. border to the Canada/Alaskan border.

Cites: IRC § 4272(b)(1); IRC § 4262(b); Facilities and Services Excise Taxes Reg. § 49.4262 (b)-1; and Rev. Rul. 75-27, 1975-1 C.B. 355.

Property Imported and Exported Entirely by Air

As noted previously, the section 4271 tax does not apply to amounts paid for transportation partially or entirely by air that (1) begins in the United States and ends outside the United States or (2) begins outside the Untied States and ends in the United States. Therefore, air shipments of property imported into the United States and air shipments of property exported out of the United States are not subject to the section 4271 tax. The domestic segments of a flight to transport property being exported are not taxable as long as the exportation is evidenced by listing the property by weight and destination on a freight manifest or on a through airwaybill. Cite: Facilities and Services Excise Taxes Reg. § 49.4271-1(c).

Importation of Property Involving Two or More Modes of Transportation

When the transportation of property begins outside the United States using a method other than air transportation, and then is transported by air from one point in the United States to another point within the United States, the amount paid for such transportation is taxable under section 4271. This is because the transportation begins and ends in the United States. Cite: Facilities and Services Excise Taxes Reg. § 49.4271-1.

Exportation of Property Involving Two or More Modes of Transportation

When two or more modes of transportation, such as over-the-road trucking, shipments by rail, and/or shipments by water, are used within the course of transporting property **for exportation**, the air transportation portion is exempt from tax. Even though the transportation of property by air begins and ends in the United States, the tax does not apply if the property is being transported in the continuous course of exportation. Cite: Facilities and Services Excise Taxes Reg. § 49.4271-1(d).

Continuous movement in the course of exportation shall be evidenced by (a) the execution of the Form 1363, Export Exemption Certificate, and (b) proof that exportation has actually occurred. Cite: Facilities and Services Excise Taxes Reg. § 49.4271-1(d)(2)(i).

Delays caused by circumstances beyond the control of the shipper, such as labor disputes or natural disasters, will not interrupt the continuous movement of the property. Property arriving by air at a gateway city to export may be repacked or consolidated with other property without interrupting the continuous movement of the property. Cite: Facilities and Services Excise Taxes Reg. § 49.4271-1(d)(1). Note that imported property is not subject to these rules.

Example:

Company E hires Transportation Company F to pick up a shipment of raw materials and deliver it to its manufacturer in Mexico. Transportation Company F contracts with Railroad A, Trucker B, and Air Transporter C to provide portions of the movement of the shipment to Mexico. At each stop and transfer, the shipment is commingled with other shipments moving to the next location and is reloaded on the next transportation provider for the next leg of the overall movement to Mexico. In this case, the tax does not apply to the air transportation portion of the overall movement of the shipment since the shipment has been a part of a continuous movement resulting in export.

Liability for Tax

The transportation of property by air excise tax is a collected tax. The person who pays for the property to be transported is the taxpayer and the air transporter is the collecting agent responsible for filing the return and forwarding the collected tax to the Government. The tax is reported on Form 720, IRS No. 27.

The tax is imposed whether the amount is paid inside or outside the United States for the taxable transportation. If the payment is made outside the United States and no tax is collected, then the person to whom the property was delivered is liable for the tax and the person furnishing the last segment of the taxable transportation shall collect the tax. Cite: IRC § 4271(b)(2).

Unlike the transportation of persons by air excise tax, there is no provision which allows the tax to be assessed against the air carrier when the tax is not paid by the taxpayer . As a result, the facts of the case must be carefully determined by the examiner and a decision must be made:

- Whether to assess a penalty against the air carrier under section 6672 for failing to collect the tax. The amount of this penalty is 100% of the amount not collected.
- Whether the tax was actually paid by the taxpayer but the collector has failed to remit the tax over to the Service. In this instance, the agent is to proceed against the collector citing IRC §§ 4291, 6672, and 7501. or
- Whether the actual taxpayer should be pursued for the underpayment of transportation of property by air tax via a direct assessment. These assessments are to be made citing IRC § 4271. Reference the IRM for procedures for “Direct Assessments.”

Freight Forwarder vs. Air Transporter

Generally, a freight forwarder is an entity that organizes the safe, efficient movement of goods on behalf of the shipper. Sometimes this service includes dealing with packing and consolidating the shipments as well as storage of shipments. Additionally, freight forwarders are able to arrange the best means of transport that meets the shipper’s and shipment’s needs, such as truck service, rail service, air service, or water transportation. They may also assist the shipper by agreeing to prepare necessary documents related to the transportation.

As noted above, the tax applies to amounts paid to a person engaged in the business of

transporting property by air for hire. Facilities and Services Excise Taxes Regulation § 49.4271-1(b)(3) states,

> Since the tax imposed by section 4271 applies only to amounts paid to persons engaged in the business of transporting property by air for hire, the tax applies to amounts paid to an air carrier by a freight forwarder or express company for the transportation of property by air. The tax does not apply to amounts paid by a shipper to a freight forwarder or express company.

Therefore, amounts paid to a freight forwarder who is not in the business of actually transporting the property by air are not subject to tax. The tax is imposed upon payment from the freight forwarder to the air transportation provider.

Because the tax is imposed on the amount paid by a "freight forwarder" to an air carrier, as opposed to the amount paid to the freight forwarder, examination issues have arisen regarding whether or not an entity is a "freight forwarder". In fact, S. Rep. No. 91-706, 91st Cong. 2nd Sess., 1970-1 C.B. 386, 395, stated:

> In the case of freight forwarders, express companies, and similar persons (**since the forwarder, etc., is not the person engaged in transporting the property by air for hire**), the tax is to be imposed upon, and measured by, the amount paid by the forwarder, etc., to the air carrier. In such a situation, the tax is not imposed upon the shipper, although it may be presumed that the amount charged by the forwarder, etc., to the shipper will take the tax into account.

Most commonly, examination issues arise when an entity related to an air carrier claims to be a freight forwarder and the tax should be imposed on the amount it pays its related air carrier. Generally, the Service considers the related entity, such as the parent corporation, to be operating as an integrated air transportation company, not a freight forwarder. If a person provides its own transportation, it is not a freight forwarder. Shippers Cooperative, Inv. v. Interstate Commerce Commission, 308 F.2d 888, 891 (9th Cir. 1962). As a result, the entity claiming to be a freight forwarder was actually in the business of transporting property by air and responsible for collecting the tax from the shippers.

Determining the "Amount Paid" Subject to IRC § 4271 Tax

Once the taxpayer and collector have been identified, it becomes important to determine the "amount paid" which is subject to tax. Although it might initially be expected that the amount paid is reflected on the airwaybill or other document, this is not always the case. Calculations may be needed to determine the amount paid when there are:

- Joint provision of services
- Payments for "accessorial services"
- Services provided by "integrated transportation companies"
- Exemptions from the tax
- Mixed loads of persons and property, and
- Charter flights.

Air Carrier Providing Joint Services with Another Entity

IRC § 4271(c) states:

> For purposes of this section, in any case in which a person engaged in the business of transporting property by air for hire and one or more other persons not so engaged jointly provide services which include taxable transportation of property, and the person so engaged receives, for the furnishing of such

> taxable transportation, a portion of the receipts from the joint providing of such services, the amount paid for the taxable transportation shall be treated as being the sum of (1) the portion of the receipts so received and (2) any expenses incurred by any of the persons not so engaged which are properly attributable to such taxable transportation and which are taken into account in determining the portion of the receipts so received.

Thus, when a true freight forwarder works jointly with an air carrier to provide transportation of property by air, it is possible to attribute "expenses incurred" by the freight forwarder as an amount paid for transportation.

The most information on this area comes from the Finance Committee amendments in 1970, which clarified the "amount paid" when there is a joint provision of services. The Committee indicated that in addition to the amount "Air Express" remitted to the air carrier, the amount paid would also include "a portion of the expenses for cooperative advertising which are deducted before the division of receipts is made between the parties." Cite: S. Rep. No. 91-706, 91st Cong. 2nd Sess., 1970-1 C.B. 386, 395.

Amounts paid for Accessorial Services

Accessorial services are taxable where they can only be provided by the carrier, either directly or subcontracted, and if all who use the service are charged for it. The amounts are taxable whether the air carrier provides the accessorial services directly or through an independent contractor. On the other hand, if the service could also be provided by another party, such as a freight forwarder, the amounts paid for the service performed by the air carrier are not considered to be amounts paid for the transportation of property by air, and are therefore not subject to the tax, if the charges for such services are separately stated.

Examples of accessorial services that would be taxable include:

- Charges for "stopping in transit"
- Charges for "proof of delivery requests"
- Excess valuation charges, and
- Charges for transporting items in the refrigerated portion of an aircraft.

Cites: S. Rep. No. 91-706 91st Cong., 2d Sess., 1970-1 C.B. 386 at 395; Rev. Rul. 71-398, 1971-2 C.B. 373.

Examples of accessorial services that are potentially nontaxable (if separately stated) because they could be provided by someone other than the air carrier:

- COD (Collect on Delivery) shipments – a service provided by carriers whereby the carrier will collect COD amounts from the consignee and forward payment to shippers;
- RFC (Remittance Following Collection) shipments – a service basically similar to the COD service described above, but provides for the extension of credit to the consignee for the amounts due on RFC shipments and for remittance following collection by the carrier;
- Assembly or distribution services – two distinct services. In providing the assembly service, the carrier will accept two or more parts of a shipment from one or more shippers at a point of origin and will provide special assembling of the parts for shipment. At a destination point, the carrier will provide distribution service that involves separating parts of a shipper's shipment and delivery of the parts to different consignees;
- Containers for live animals – a service where containers are rented or sold by carriers for use in the air transportation of animals;
- Signature service – a service providing for a person to person receipt by individuals involved in the handling of specific freight shipments;

- Charge for the use on an insulated container – a service where a carrier furnishes insulated containers for carriage of special air freight shipments;
- Terminal service charges – a service where the carrier prepares export and entry documents and processes customs clearance;
- Proof of delivery request – a form of terminal service charge assessed by carriers when proof of delivery is requested by the shipper. The carrier furnishes to the shipper a photocopy of the airbill or manifest signed by the consignee, or his agent;
- Charge for packing shipments – a service where the carrier, using special packaging materials, packages electronic machines and office machines for the shipper; and
- Charge for the use of a container – a service where the carrier furnishes multiple-use containers or single-use containers, including containers that are designed as "fish-pack" containers for fin fish and shell fish.

In order for the charges for the accessorial services listed above to not be taxable, they must be separately stated to the customer purchasing the air transportation. Cite: Rev. Rul. 71-398, 1971-2 C.B. 373.

Allocation between Air and Ground Costs

With the change in regulatory requirements over the years, many companies have become integrated transportation companies that provide both ground and air transportation. For example, it is not uncommon for an entity to send a truck to pick up a package from a customer, then transport that customer's package between the origination city to another city via its own aircraft, then deliver the shipment to the recipient via truck. As this integrated transportation generally involves nontaxable accessorial services, complex calculations are usually made by the transportation company in arriving at the amount they deem taxable.

If an examination involves such an entity, contact the SBSE EIS or Policy Analyst for Air Transportation Excise Taxes or the LMSB Air Transport Technical Advisor for assistance.

Exemptions from Tax

In general, all users are subject to the taxes on the amounts paid for taxable air transportation of persons and property. However, exemptions from the tax are provided as follows:

Small Aircraft on Nonestablished Lines

The taxes imposed by section 4271 shall not apply to transportation by an aircraft having a maximum certificated takeoff weight of 6,000 pounds or less, except when such aircraft is operated on an established line. Cite: IRC 4281. For purposes of the preceding sentence, the term "maximum certificated takeoff weight" means the maximum such weight contained in the type certificate or airworthiness certificate. An aircraft is operated on an established line if the route is operated with some regularity between definite points. For additional information, see Chapter 2, Exemptions to the Section 4261 Tax.

Excess Baggage of Passengers

The taxes imposed by section 4271 are not imposed on excess baggage accompanying a passenger traveling on an aircraft operated on an established line. Cite: IRC § 4272(c).

Attendants Accompanying Shipments

The amounts paid for attendants accompanying shipments such as guards, or couriers are amounts paid for the transportation of persons, and it is held that the amounts are subject to the tax imposed by section 4261 rather than the tax imposed by section 4271. Cite: Rev. Rul. 71-398, 1971-2 C.B. 373. See Facilities and Services Excise Taxes Reg. § 49.4261-8(b)

for an exception to this rule.

Aerial Services

The air freight tax does not apply to amounts paid for aerial services such as:

- crop dusting,
- aerial fire fighting services, or
- the use of helicopters in construction
    - to settle heating and air conditioning units on roofs of buildings,
    - to dismantle tower cranes
    - of power lines or
    - of ski lifts.

Cites: Rev. Rul. 72-156, 1972-1 C.B. 331; Rev. Rul. 74-496, 1974-2 C.B. 370; S. Rep. No. 91-706, 91st Cong. 2nd Sess., 1970-1 C.B. 386,395.

Medical Services

The air freight tax does not apply on any air transportation for the purpose of providing emergency medical services:

- by helicopter, or
- by a fixed-wing aircraft equipped for and exclusively dedicated on that flight to acute care emergency medical services.

Cite: IRC § 4261(g). The exemption applies even if the helicopter or fixed wing aircraft takes off or lands at aviation facilities that receive federal assistance. The most common use of this exemption is for shipments of donated human organs. However, it is important to remember the transportation of human organs will not be exempt if they are transported on a fixed wing aircraft with other passengers or shipments.

Skydiving

No tax shall be imposed by section 4271 on any air transportation exclusively for the purposes of skydiving. Cite: IRC § 4261(h).

Seaplanes

Beginning on October 1, 2005, the transportation of property by air is not imposed on air transportation by seaplanes. In order to be exempt, the segment flown by the seaplane must consist of a take-off from, and a landing on, water. However, the tax will be imposed if the places at which the takeoff and landing occur have received or are receiving financial assistance from the Airport and Airway Trust Fund. Cite: IRC § 4261(i).

Affiliated Groups

The affiliated group exemption under section 4282 also applies to the transportation of property by air. Reference the discussion of affiliated groups.

The Amount Paid When Charters are Involved

Often large shippers may charter an aircraft to transport property. In these cases, the section 4271 tax is still imposed on the amount paid for the transportation. Therefore, the section 4271 tax is imposed on the sum of:

- The amount paid for the flight(s), plus
- The amount paid for crew expenses such as: pilot meals, pilot and crew lodging, and waiting time,
- The cost of a deadhead flight which includes all costs for returning an empty plane to the base hangar,
- Sales taxes,
- Landing fees,
- Parking,
- Fuel surcharges, and
- Any other amount related to the charter flight to transport the property.

Determining the Amount Paid for Mixed Load of Persons and Property

A singe amount paid for the air transportation of a mixed load of persons and property must be allocated between the portion of the flight for the transportation of persons and the portion of the flight for the transportation of property. A reasonable basis for this allocation must be used and the allocation must be supported by adequate records. Once the allocation is made, the applicable taxes under section 4261 are imposed on the amount allocated to the transportation of persons by air and the tax under section 4271 is imposed on the amount allocated to the transportation of property by air. Cite: Rev. Rul. 72-585, 1972-2 C.B. 578.

Examination Techniques

Examination techniques for transportation of property by air exams are mostly the same as techniques for transportation of persons by air. The techniques listed below are not all-inclusive and should not be deemed as mandatory but rather as a starting point or points to consider when conducting these examinations.

- Obtain and review complete transcripts of the Taxpayer. This will provide the information concerning the type of entity you are dealing with. The taxpayer may be a subsidiary of a large corporation. In this case, the LMSB Case Manager is to be consulted.
- Review the filed Form 720. Look for abstracts on which tax is being reported. For instance, if tax is only reported on abstract # 028, then there is a possibility that the Taxpayer may be combining multiple abstracts into one line entry on the Form 720;
- Review the Form 720, Schedule C, noting the types of fuel claims. Note that some taxpayers will combine all fuel claims on one line;
- Review the Form 720, Schedule A, to determine the method of tax deposits used by the Taxpayer. This is important because it is not unusual for a Taxpayer to report under the regular method when in fact, the Taxpayer is actually using the alternative method. The alternative method is much simpler to use and normally the accounting systems can be set up to track FET under the system. The regular method requires a greater detail of information and most accounting systems are not set up to efficiently track the FET as it is collected. The regular method generally requires the Taxpayer to track collections on separate workpapers;
- Compare the tax due on the income reported on the income tax returns and with the amount of tax reported on the Form 720 for the same period. While this will not match perfectly, large differences should be questioned during the initial interview;
- Review all refund claims filed on Form 8849, Form 843, and Form 4136;
- Perform an Internet search on the taxpayer. Note the kind of services being provided by the Taxpayer. Most charter and aircraft management companies have very elaborate websites and provide numerous services;
- Go to the FAA website and search for the aircraft the Taxpayer may own and note the type of operator's certificates held by the Taxpayer;
- Do a search on Accurint for the Taxpayer. This will give you some basic information about the Taxpayer.
- In examinations of large companies, note that most are publicly held and issue annual reports to their stockholders. Reviewing these reports for 1 or more years will give important information about the taxpayer's overall activities;

- Another source of information on large companies is the Securities and Exchange Commission Form 10K (annual report and related documentation), if required to be filed. Large companies may produce their own newsletters, which are valuable tools for learning about changes in company functions and everyday business practices. Large companies may also produce trade magazines or other publications.

During the initial contact call, verify the information on the Form 720. Additional information to be secured from the Taxpayer at this time includes:

1. The types of services that the Taxpayer offers. For instance does it offer international flights? Do they offer transportation of persons? Often companies will provide transportation of persons on the same flights as their property flights but will combine the tax on one abstract.
2. What type of FAA certificate does the Taxpayer operate under?

In preparing the appointment letter and initial IDR, the following items are to be considered in order to save time by requesting them up front:

1. Copies of any workpapers used to prepare the return.
2. A copy of the chart of accounts. The chart of accounts will provide clues into accounts that may be taxable but are being missed by the air transportation provider.
3. A written narrative of how they account for and track FET along with who performs each function. Have the taxpayer provide a flow chart of the process from the time a contract for the movement of property is quoted and purchased to the report that shows the tax due. Obtain an explanation of how the air transportation provider determines what charges are taxed and what charges are not taxed. Obtain the reports which are prepared which detail the various charges taxed.
4. Obtain a list of services the taxpayer provides that are considered to be taxable.
5. Obtain a list of services the taxpayer provides that are considered to be non-taxable.
6. Obtain an explanation of how the taxpayer accounts for all fuel purchased and used.
7. Note how the taxpayer determines the number of gallons of fuel that have been taxed and at what rate the fuel was taxed at.
8. Note how the taxpayer determines the number of gallons of fuel used for foreign trade and the number of gallons used for other tax-exempt purposes.
9. Request supporting workpapers and verify that each fuel claim filed is allowable.
10. Perform a detailed examination of cost centers to determine whether the formulas are consistent with a proper allocation of the costs. To perform this function, considerable knowledge of the company's business practice is necessary. Flowcharts, charts of accounts, access to computer files, and an experienced computer audit specialist are needed on such exams.
11. When there are both air/ground or supplemental costs are incorporated in dedicated expenses, a study should be made of these cost centers if the integrated company has not made allocations in the original computation.

At the first on-site interview, the tax manager, along with all persons who are responsible for accounting for the tax and for selling the transportation of property by air are to be present.

1. Reconcile total property transportation tax collected per book to the tax on the Form 720 to verify that all tax collected has been remitted. Explain discrepancies.
2. Reconcile adjustment items on the Form 720 to verify that the air transporter is entitled to the adjustment. Review corresponding accounts for blind credits.
3. Review the general ledger and question the non-taxed revenue accounts to verify what the accounts do not contain taxable property revenue.
4. Review liability accounts, paying attention to all sources of tax, especially any unusual debits to the account. Reconcile the liability at the end of the last quarter to ensure that the accrued liability is correct.
5. Air transporters may make tax deposits based on amounts considered as collected (the “alternative method”) under Excise Tax Procedural Regulations § 40.6302(c)-3, and make adjustments the next month. Verify that the correct adjustment has been

made and determine that the amounts considered as collected are accurate.

6. Make sure the companies are using only one method of deposits during the quarter, either the regular method or the alternative method is to be used. Cite: Excise Tax Procedural Reg. §§ 40.6302(c)-1 and 40.6302(c)-3.
7. Exemptions usually allowed to various organizations or governmental agencies are not allowed for the transportation of property by air tax. Verify that exemptions were not granted to state or local governments, the United States and its possessions, diplomats, nonprofit educational organizations, or human organ transplant teams.
8. Be alert to exemptions claimed for exported property especially when multiple stops are involved.
9. Be alert to exemptions claimed by freight forwarders. Determine who is the taxpayer in each flight situation.
10. An integrated company (having both air and ground business) may calculate the tax by allocating revenue between ground transportation and air transportation based on its costs. Ensure that the carrier correctly allocates costs as either nontaxable ground cost or as taxable air cost. Erroneous allocations may cause an understatement or overstatement of tax. (An overstatement of tax cannot be refunded to the carrier unless the carrier has refunded the amount to the customer or has obtained the customer's permission to claim the refund. Cite: IRC § 6415.
11. The company may have a complicated cost accounting system that requires detailed examinations of cost centers to determine whether the formulas utilized in determining revenue subject to section 4271 are consistent with a proper allocation of the costs. To examine such a cost accounting system, considerable knowledge of the company's business practice is necessary. Flowcharts, charts of accounts, access to computer files, and an experienced computer audit specialist are needed on such exams.
12. Direct air cost, direct ground cost, and indirect costs must be correctly allocated to arrive at the correct amount of tax. When there are both air/ground or other costs incorporated in dedicated expenses, a study should be made of these cost centers if the integrated company has not made allocations in the original computation.
13. Review the allocation of costs for sorting facilities or super hubs.
14. Review aviation fuel purchases. Only the ultimate purchaser of aviation fuel is entitled to the refund or credit if cargo taxes are collected and paid over to the Government.
15. Review claims and credits for aviation fuel. Large cargo companies may have a direct pipeline to the airport loading facilities at their main shipping locations. In this case, the fuel may be purchased in bulk fuel tax-free or at a tax-reduced rate using Form 637. Ensure that these purchases are not included with any credits claimed for away-from-home-base, tax-included purchases.

Collected Taxes and Deposits

Introduction

The air transportation excise taxes are facilities and services excise taxes. Facilities and services taxes are imposed on the amount paid for the use of a facility or a service provided. These taxes are classified as collected taxes and are reported on Form 720. Collected taxes are paid by the person who receives the service or uses the facility. The term “collected tax” stems from the fact that the person furnishing the service or facility must act as a collecting agent for the tax imposed on the person paying for the service or facility. It is important to remember when dealing with air transportation taxes that the customer is the taxpayer and the air transportation provider is the collecting agent.

Form 720, Quarterly Federal Excise Tax Return, is used to report and pay excise taxes and it is required for each calendar quarter. Cite: Excise Tax Procedural Reg. § 40.6011(a)-1.

Collected vs. Noncollected Excise Taxes

The essential difference between a collected and a noncollected excise tax is that a noncollected excise tax is imposed directly on the seller (taxpayer) who must pay it whether

or not the customer ultimately pays it. Most excise taxes are noncollected taxes. The exceptions are collected taxes under facilities and services excise taxes. As noted above, a collected tax is levied against the party paying for the service or use of the facility. However, the provider of the service or facility must collect the tax from the taxpayer, file the Form 720, and remit the collected tax to the Government.

The person paying for the service or facility is liable for the tax at the time of payment. Once payment is made to the collector, the amount of tax so paid is to be held in trust for the United States. If the collector furnishing the facility or service does not collect the tax, the tax may be assessed directly against that person.

Air Carrier Liability as Taxpayer

The Taxpayer Relief Act of 1997 amended section 4263(c) to provide that, if the air transportation of persons tax under section 4261 is not paid at the time the payment for transportation is made, the tax is to be paid by the carrier providing the initial segment of transportation that begins or ends in the United States. This provision is generally effective for amounts paid on or after October 1, 1997, for travel on or after October 1, 1997. The section 4263(c) liability provision only applies to taxes imposed under section 4261. Therefore, it does not apply to the section 4271 tax imposed on the transportation of property by air.

Methods of Accounting for Collected Taxes and Deposits

There are two methods of accounting that can be used by the collecting agent to account for collected taxes: the regular method and the alternative method. Once the alternative method is elected, the collector must continue to use the alternative method to account for the collected excise taxes. Should the collector wish to change to the regular method, the collector will need to request permission to change its accounting method from the Service.

Regular Method

Under Excise Tax Procedural Regulations § 40.6302(c)-1, the Regular Method treats the collected tax as a tax liability incurred during the semimonthly period in which that tax is actually collected. Cite: Excise Tax Procedural Reg. § 40.6302(c)-1(a)(2)(i). The deposit of tax for a semimonthly period is due by the 14th day following the period in which the tax is collected. Generally, this is the 29th day of a month for the first semimonthly period and the 14th day of the following month for the second semimonthly period. If the 14th or the 29th day falls on a Saturday, Sunday, or legal holiday, the collector must make the deposit by the immediately preceding day that is not a Saturday, Sunday, or legal holiday. In order to determine the amount of the semimonthly deposit, the amount may be figured by dividing the net tax liability for the month by two. If this method of computation is used then it must be used for all semimonthly periods in the calendar quarter.

The collector reports the total liability for the period on the line for the tax being filed. Any claims or adjustments are usually shown on Schedule C (Form 720). The net tax liability for a reporting period is then reflected in Part III of the Form 720.

Alternative Method

Under Excise Tax Procedural Regulations § 40.6302(c)-3, the Alternative Method treats the tax as a tax liability incurred during the semimonthly period in which that tax is considered as collected. Cite: Excise Tax Procedural Reg. § 40.6302(c)-1(a)(2)(ii). Under this method, the tax included in tickets sold during a semimonthly period is considered collected during the first 7 days of the second month following semimonthly period. The deposit of tax is due by the 3rd banking day after the 7th day of that period.

Example:

The tax included in tickets sold for the period from December 16, 1997, to December 31, 1997, is considered collected from January 16, 1998, to January 22, 1998, and must be deposited by January 27, 1998.

See Publication 509, Tax Calendars, for the due dates of these deposits for the current year.

The tax for the period is the amount included in tickets sold, not the amount of tax that is actually collected. For example, tickets sold in December, January, and February are considered collected during January, February, and March and are reported on Form 720 as the tax for the 1st quarter of the calendar year.

If the air transportation provider elects to report the tax and make deposits based on the Alternative Method, the regulations require the air transportation provider to separately account for the tax. Cite: Excise Tax Procedural Reg. § 40.6302(c)-3(b)(ii)(2). To use the alternative method, the collector must maintain a separate account in which the tax included in tickets sold during the month is accounted for. For each month, the account must reflect all transactions with the air transportation taxes, including:

- Items of tax that are included in tickets sold during the month, and
- Items of adjustment relating to the tax for the prior months (within the statue of limitations on credits or refunds).

The collector reports and deposits the net amount in the account at the end of the period. The negative adjustments to the Alternative Method account are often referred to as “blind credits” as these credits are not shown on a return but are netted directly against the tax collected. It is important to note that a negative adjustment to the alternative method account cannot be made for a refusal to pay or inability to collect unless the refusal has been reported to the IRS under section 4291. Additional information on section 4291 is discussed later in this Chapter.

Under the Alternative Method, the deposit of tax for any semimonthly period must not be less than the net amount of tax that is considered collected during the semimonthly period. The net amount of tax that is considered collected during the semimonthly period must be:

- The net amount of tax reflected in the separate account for the corresponding semimonthly period of the previous month, or
- One-half of the net amount of tax reflected in the separate account for the preceding month.

Safe Harbor Rule

Generally, semi-monthly deposits of excise taxes are required. A semimonthly period is the first 15 days of a month (the first semimonthly period) or the 16th through the last day of a month (the second semimonthly period). Schedule A (Form 720), notes the deposits made during the quarter.

Deposits for a semimonthly period generally must be at least 95% of the net tax liability for that period unless the safe harbor rule applies. The safe harbor rules apply separately to deposits under the Regular Method and the Alternative Method.

For the safe harbor rule, the collector must have filed a Form 720 for the second calendar quarter, called the look-back quarter, that precedes the current quarter. If the collector filed for the look-back quarter, the collector will have met the semimonthly deposit requirement for the current quarter if all of the following conditions are met:

1. The deposit of tax for each semi-monthly period in current quarter is not less than 1/6 (16.67 percent) of the net tax liability reported for the look-back quarter.
2. Each deposit is timely made at an authorized Government depository, and
3. The collector pays any underpayment for the current quarter by the due date of the return.

For the semimonthly period for which the additional deposit is required (September Rule), the additional deposit must be at least 12.23% or 11.12% for non-EFTPS of the net tax liability reported for the look-back quarter. Also, the total deposit for that semimonthly period must be at least 1/6 (16.67 percent) of the net tax liability reported for the look-back quarter.

Exceptions to the Safe Harbor Rule

The safe harbor rule does not apply to:

- The 1st and 2nd quarters beginning on or after the effective date of an increase in the rate of tax unless the deposit of taxes for each semimonthly period in the calendar quarter is at least 1/6 (16.67 percent) of the tax liability that would have been incurred for the look-back quarter if the increased rate of tax had been in effect for that look-back quarter; or deposits of any tax if the tax was not in effect throughout the look-back quarter.
- Any quarter, if the tax liability includes any tax not in effect throughout the look-back quarter, or
- Any quarter under the alternative method, if the tax liability includes any tax not in effect throughout the look-back quarter and the month preceding the look-back quarter.

Note: The collector's right to make deposits of tax using the safe harbor rule can be withdrawn from the collector for not complying with these rules.

September Rule for Deposits

All excise taxes that must be deposited are subject to special September rules. Under these rules, an additional deposit is required in September. A different deposit date may apply if the collector is required to make electronic deposits. Taxes for the part of the period not covered by the special September rule should be deposited by the normal due date. Cite: Excise Tax Procedural Reg. §§ 40.6302-2 and 40.6302-3.

Additional deposit of taxes in September 2007

For the Period

Type of Tax	Beginning on	Ending on	Deposit Due On
Regular method taxes			
EFTPS1	Sept. 16	Sept. 26	Sept. 28
Non-EFTPS	Sept. 16	Sept. 25	Sept. 28
Alternative method taxes			
EFTPS1	Sept. 1	Sept. 11	Sept. 28
Non-EFTPS	Sept. 1	Sept. 10	Sept. 28

Electronic Deposits

Most collectors must use the Electronic Federal Tax Payment System (EFTPS) to make electronic deposits. If the collector is an employer required to use EFTPS, it must also use EFTPS to deposit excise taxes. The collector must make electronic deposits for all depository taxes if it had to make electronic deposits in the prior year or if total deposits of income tax withheld and Social Security, Medicare, and Railroad Retirement taxes were more than $200,000 in the prior year. If it does not meet these conditions, electronic deposits are voluntary.

Federal Tax Deposit Coupons

If the collector is not required to use EFTPS and does not voluntarily participate in the EFTPS Program, deposits of federal excise taxes are made using Form 8109, Federal Tax Deposit Coupon, at an authorized financial institution.

Return Due Dates

The taxes are reported on Form 720. The Form 720 must be filed by the following due dates:

Quarter Covered	Due Dates
January, February, March	April 30
April, May, June	July 31
July, August, September	October 31
October, November, December	January 31

If any due date falls on a Saturday, Sunday, or legal holiday, the return can be filed on the next business day.

Claims for Refund of Collected Excise Taxes

Under section 6402, the Secretary has the authority to make a refund or credit of any overpayment of any tax to the person who made the overpayment. Section 6415(a) states that a credit or refund of any overpayment of tax imposed by section 4261 or 4271 may be allowed to the person who collected the tax and paid it to the Secretary if such person establishes, under such regulations as the Secretary may prescribe, that he has repaid the amount of such tax to the person from whom he collected it, or obtains the consent of such person to the allowance of the credit or refund.

Section 6415(b) states that any person entitled to a refund of tax imposed by section 4261 or 4271 paid, or collected and paid, to the Secretary by him may, instead of filing a claim for refund, take a credit therefore against taxes imposed by such section due upon any subsequent return.

There are no regulations under section 6415. Therefore, we also look to Excise Tax Procedural Reg. §§ 40.6302(c)-1, 40.6302(c)-2 and 40.6302(c)-3 for claims involving air transportation taxes. If the collector elects to use the alternative method for accounting for the tax, under Excise Tax Procedural Regulations § 40.6302(c)-3, the collector is allowed to adjust its alternative method account for adjustments arising from refunds of monies for tickets. Cite: IRC 6415 and Excise Tax Procedural Reg. § 40.6302(c)-3.

Usually, when the collector refunds any portion of a ticket, it will also adjust the air transportation excise tax imposed on the original ticket sale and include the excise tax refund

in the amount refunded to the customer/taxpayer. The excise tax refunded will be a negative adjustment to the alternative method account and will reduce the amount of tax considered billed or sold during that period.

Where the collector uses the Regular Method to account for the tax, the only person allowed to file a claim for refund of air transportation taxes is the actual taxpayer, unless the collector meets certain requirements. The collector that uses the regular method is only allowed to file for a claim if written permission is received from the actual taxpayer or the collector has already refunded the tax to the taxpayer. Cite: IRC § 6415(a).

Administrative Procedures for Collected Taxes

Additional care is needed when dealing with collected taxes. Collected taxes have the ability to present unique situations where the collecting agent fails to collect the full amount of tax and include the correct tax amount on a filed return. This failure raises questions concerning upon whom the Service will assess the tax, whether penalties can be applied, and how to protect the statute of limitations on a filed return case.

Tax Assessments

The important thing to remember is that the duty to collect transportation taxes is imposed on the collector. However, the consumer/taxpayer is not relieved of his or her liability for the tax. Even though a collector may fail to collect the tax, liability for the tax does not automatically shift to the collector for those situations under section 4263(c) for taxes imposed under section 4261. When it is determined that the air transportation provider is liable, the deficiency will be proposed against the carrier under section 4263(c).

In the case of an air transportation provider who fails to collect taxes imposed under section 4271 for the transportation of property by air, the Service will request the collector to collect "back taxes" due from the individual customers/taxpayers. In this case, most collectors try to comply with this request as they do not want to have their customers contacted by the Service for the additional tax. If the collector attempted to collect the "back taxes" and is not successful, then the Service can proceed with direct assessments against the customer(s).

Direct Assessments

As noted previously, the duty to collect transportation of property taxes is imposed on the provider of the air transportation. If the collector fails to collect and remit the section 4271 tax, or if an air transportation provider fails to collect and remit the section 4261 tax and, in addition, follows the procedures outlined in section 4291, as discussed below, the Service will directly assess the unpaid tax against the consumer of the air transportation service. The procedures for a direct assessment can be found in IRM 4.24.4.8.2 (2/1/2003).

IRC 4291 Notifications for Inability to Collect Tax

The regulations under section 4291 allow for the air transportation provider to be able to notify the Service of the inability to collect the air transportation tax from any party. If the requirements of the regulation are met then the air transportation provider is relieved of their liability for the tax so reported. The Service will proceed to collect the tax from the person to whom the air transportation was provided. Facilities and Services Excise Taxes Regulations § 49.4291-1 states:

> If the person from whom the tax is required to be collected refuses to pay it or if for any reason it is impossible for the collecting agent to collect the tax from the person, the collecting agent is required to report to the Commissioner the name and address of that person, the nature of the facility provided or service rendered, the amount paid therefore, and the date on which paid.

The notification is due to the Commissioner by the due date of the return on which the item of adjustment relating to the uncollected tax would be reflected for those collecting agents using the alternative method of reporting the tax. For those collecting agents not using the alternative method, the notification is due to the Commissioner by the due date of the return on which the tax would have been reported.

Trust Fund Recovery Penalty

Section 6672 provides for a 100-percent penalty when the collector willfully fails to collect, truthfully account for, or remit collected taxes. When willfulness is indicated, the case is referred to the Collection Division for a determination of the applicability of section 6672.

If the Collection Division accepts the case, it will assess the penalty. The penalty is used as a collection device, and no tax is assessed if the penalty is collected.

Statute of Limitations

With collected taxes, special care is needed to ensure that all aspects of the statute of limitations for filed returns are protected. The forms and wording needed to accomplish this task depends upon the type of entity under audit.

For Collectors, the following forms are to be secured:

Form 2750, Waiver Extending Statutory Period for Assessment of Trust Fund Recovery Penalty, is to be secured for each tax period under audit. The form can be prepared for the entity or for each responsible official depending upon the facts and circumstances of the case. This form will protect the statute for the imposition of the Trust Fund Recovery Penalty under section 6672.

Form 872-B, Consent to Extend the Time to Assess Miscellaneous Excise Taxes, is to be secured to protect the liability for collected taxes under section 7501. The wording to be used depends upon the type of tax being protected. The underlined items are the entries which must be entered onto the form.

For the transportation of persons by air tax, the form is to specify the following:

The amount of liability for collecting remitting IRC 4261 Taxable Transportation by Air tax, imposed on the taxpayer(s) by section 7501 and 4291 of the Internal Revenue Code.

For the transportation of property by air tax, the form is to specify the following:

The amount of liability for collecting remitting IRC 4271 Taxable Transportation by Air tax, imposed on the taxpayer(s) by section 7501 and 4291 of the Internal Revenue Code.

For Taxpayers the following forms are to be secured:

Form 872-B, Consent to Extend the Time to Assess Miscellaneous Excise Taxes, is to be secured to protect the liability for the taxes imposed under section 4261 and 4271. The wording to be used depends upon the type of tax being protected. The underlined items are the entries which must be entered onto the form.

For the transportation of persons by air tax, the form is to specify the following:

The amount of liability for Taxable Transportation by Air tax, imposed on the taxpayer(s) by section 4261 of the Internal Revenue Code.

For the transportation of property by air tax, the form is to specify the following:

The amount of liability for Taxable Transportation by Air tax, imposed on the taxpayer(s) by section 4271 of the Internal Revenue Code.

For Air Carriers the following forms are to be secured:

Form 872-B, Consent to Extend the Time to Assess Miscellaneous Excise Taxes, is to be secured to protect the liability for the tax imposed on the air carrier under section 4263. The underlined items are the entries which must be entered onto the form.

The amount of liability for IRC 4261 taxes not paid or collected under any other provision tax, imposed on the taxpayer(s) by section 4263 of the Internal Revenue Code.

Cite: Memorandum from Sharon M. Oliver, Director of Reporting Compliance, dated May 23, 2001, entitled Collected Taxes – Statute of Limitations. The memorandum references Field Service Advice 200101032.

References

- IRM Part 4, chapter 4.24, Excise Tax Handbook, sections 4.24.6.3, 4.24.4.8.2, 4.24.9.5, 4.24.9.5.1, 4.24.9-1, and 4.24.9-2.
- IRC § 6302, Excise Tax Procedural Reg. §§ 40.6302(c)-2 and 40.6302(c)-3,
- IRC § 4261,
- IRC § 4263,
- IRC § 4291, Facilities and Services Excise Tax Reg. § 49.4291-1, Rev. Rul. 58-300, 1958-1 C.B. 454; amplified by Rev. Rul. 59-306, 1959-2 C.B. 422
- IRC § 6601; Procedure and Administration Reg. § 301.6601-1
- IRC § 6672; Procedure and Administration Reg. § 301.6672-1

Aviation Fuel Taxes, Credits, and Refunds

Introduction

Two types of aviation-related fuels are taxed: aviation gasoline and aviation fuel other than aviation gasoline. Each is taxed at a different tax rate. Also at issue is whether the fuel is used in commercial or noncommercial aviation.

Aviation Gasoline

Aviation gasoline, also called “avgas”, is a high octane specialty gasoline product that is usually used only in small, piston-driven aircraft. Avgas has lead as an additive, unlike gasoline sold for over the road use. Avgas includes all special grades of gasoline suitable for use in aviation reciprocating engines and is defined by ASTM specification D910 or military specification MIL-G-5572.

Aviation Gasoline Taxable Events

Section 4081(a)(1) imposes an excise tax on certain removals, entries, or sales of aviation gasoline. In practice, tax is imposed when the gasoline is removed from a terminal at the terminal rack. The position holder with respect to the gasoline is liable for the tax. All removals of aviation gasoline are taxed at $.194 per gallon, which includes the $.001 per gallon Leaking Underground Storage Fund tax (LUST), .If the aviation gasoline is later used for an exempt purpose, a claim may be filed for refund. The rules for filing claims are discussed below in Credits and Refunds of Aviation Gasoline. Refer to Manufacturers and Retailers Excise Taxes Regulations §§ 48.4081-1 through 48.4081-3 for gasoline tax liability

rules.

Aviation Gasoline Exemptions

There are no exemptions from the section 4081 tax on aviation gasoline based on the intended use of the gasoline at the time of removal from the terminal. In other words, the aviation gasoline excise tax is imposed on all aviation gasoline that is removed at a rack. If the aviation gasoline is later consumed in an aircraft flown for an exempt purpose, then a claim for refund may be filed.

Note that for aviation gasoline used or purchased after October 1, 2005 a claim for the .01 cent per gallon LUST tax may not be made, except for gasoline used in foreign trade or exported.

Aviation Gasoline Claims by Registered Ultimate Vendors

Claims for fuel used by a state or local government, or by a nonprofit educational organization, may be made by the gasoline ultimate vendor as long as the ultimate vendor is registered under section 4101 and the purchase is not made on a credit card. The ultimate vendor must have purchased the aviation gasoline on which the section 4081 tax has been paid and must sell the aviation gasoline to an ultimate purchaser for use by a state or local government or by a nonprofit educational organization. Cite: IRC § 6416(a)(4). The claim is made on Schedule 2 (Form 8849).

Aviation Gasoline Claims by Registered Credit Card Issuers

If gasoline is purchased with a credit card issued to an exempt user (that is, a state or local government for its exclusive use or a nonprofit educational organization for its exclusive use), section 6416(b)(4)(B) provides that the credit card issuer is the person that makes the claim if:

1. the credit card issuer is registered under section 4101;
2. the amount of tax has not been collected from the person who purchased the gasoline, or the credit card issuer has obtained written consent from the ultimate purchaser to the allowance of the credit or refund, and
3. the credit card issuer has repaid or agreed to repay the amount of the tax to the ultimate vendor, has obtained the written consent of the ultimate vendor to the allowance of the credit or refund, or has made arrangements which provide the ultimate vendor with reimbursement of the tax.

The claim is made on Schedule 8 (Form 8849) or on Schedule C (Form 720).

Aviation Gasoline Claims by the Ultimate Purchaser

Generally, if neither the ultimate vendor nor the credit card issuer may claim a credit or refund of tax paid on aviation gasoline, the ultimate purchaser is the claimant. The gasoline must have been sold for a use listed below. Cite: IRC § 6421(c).

- Used in commercial aviation (other than foreign trade).
- Used in foreign trade.
- Used in export.
- Used in an off-highway business use.
- Used in certain aircraft as described in sections 4261(f) and (g). (See the discussion of these provisions under Aviation Fuel later in the chapter.)
- Used in an aircraft owned by an aircraft museum.
- Used in a military aircraft.

- Used on a farm for farming purposes (Credit only; see the discussion under Aviation Gasoline Claims – Use on a Farm for Farming Purposes later in the chapter.)
- Exclusive use by a qualified blood collector organization.
- Exclusive use by a state, political subdivision of a state or the District of Columbia (but only if the registered ultimate vendor or credit card issuer does not make the claim).
- Exclusive use by a non-profit educational organization (but only if the registered ultimate vendor or credit card issuer does not make the claim).

The claim is generally made on Schedule 1 (Form 8849).

Aviation Gasoline Claims – Used on a Farm for Farming Purposes

The ultimate purchaser of aviation gasoline for use on a farm for farming purposes may claim a credit of tax imposed, but not a refund. Under section 6420, an income tax credit is allowable to the ultimate purchaser of aviation gasoline used on a farm for farming purposes. The term "used on a farm for farming purposes" is defined in Manufacturers and Retailers Excise Taxes Regulations § 48.6420-4. The credit is claimed on Form 4136, Credit for Federal Tax Paid on Fuels.

There is a special rule for the use of aviation gasoline in the aerial application of fertilizer, pesticides, or other. If a person using the gasoline is an aerial applicator, and is the ultimate purchaser of the gasoline, then the applicator, and not the owner, tenant, or operator of the farm is treated as having used the gasoline on the farm for farming purposes. See 6420(c)(4)(B).

Aviation Fuels Other Than Gasoline (Aviation Fuel)

Aviation fuel, other than gasoline or diesel fuel, is usually kerosene-based and is often referred to as "jet fuel," "kero-jet," or "jet-A" aviation fuel. It is clear of color and is used in all commercial jets, corporate jets, and turbo-prop commercial aircraft. References in this document to "aviation fuel" are references to aviation fuel other than gasoline.

Background of Tax

Before April 1, 1988, section 4041(c) imposed a tax when any liquid other than gasoline was sold by a retailer and delivered into the fuel supply tank of an aircraft in noncommercial aviation, or was used as such a fuel by a buyer who purchased the fuel in a nontaxable transaction.

From April 1, 1988, to December 31, 2004, tax was imposed by section 4091 on the sale of aviation fuel by the producer or importer thereof. Producers included registered wholesale distributors. Registered producers (Form 637 "H" Registrants) could make tax-free sales to other registered producers. Thus, in practice, usually the tax was not imposed until a registered wholesale distributor sold the fuel to a retailer at an airport (often referred to as a "fixed-base operator" or "FBO") or to the end user of the fuel.

There were no regulations under section 4091. Instead, agents and taxpayers relied upon the following notices for guidance:

- Notice 88-30, 1988-1 C.B. 497, which provides rules for making tax-free sales of aviation fuel to producers of aviation fuel
- Notice 88-132, 1988-2 C.B. 552, which provides rules for making tax-free and tax-reduced sales of aviation fuel for certain aviation fuel uses
- Notice 89-38, 1989-1 C.B. 679, which defines wholesale distributor

Effective January 1, 2005, The American Jobs Creation Act of 2004 (AJCA), Section 853,

amended the code sections that controlled the taxation of aviation fuel. It also revised provisions for the filing of claims for aviation fuel used for a nontaxable purpose. This law repealed code section 4091 and 4092 plus the applicable notices.

The most notable change made by AJCA is that the point at which tax on aviation fuel is imposed is moved to the terminal rack. If the fuel is not removed from a terminal directly into the fuel tank of an aircraft, it is taxed at the over-the-road fuel tax rate of 24.4 cents per gallon.

Now, taxpayers engaged in commercial aviation can file a claim for refund or credit for the difference between the over-the-road rate of 24.4 cents per gallon and the commercial rate of 4.4 cents per gallon. Cite: IRC § 6427(l)(4).

For fuel sold for use in non-commercial aviation, the ultimate purchaser may make the claim or give a waiver to the ultimate vendor. For fuel used in nonexempt, noncommercial aviation, the ultimate vendor is the only permissible claimant for the 2.5 cents per gallon. Cite: IRC § 6427(l)(4).

Because of these changes the following discussions concerning aviation fuel will be limited to changes in the law effective January 1, 2005, and after.

For periods before January 1, 2005, refer to the applicable Pub 378, section 4091, 4092, 4041, the regulations and the above notices. From January 1, 2005, to September 30, 2005, refer to Notice 2005-04, 2005-2 I.R.B. 289. Subsequent changes were made to Notice 2005-04 by Notice 2005-24, 2005-1 C.B. 757,, Notice 2005-62, 2005-2 C.B. 443, and Notice 2005-80, 2005-2 C.B. 953. Finally, Tax Relief and Health Care Act of 2006, Section 420, Pub. L. 109-432, made additional changes to the code concerning aviation fuel and aviation fuel claims. Some of these changes were retroactive back to October 1, 2005.

Imposition of Tax

Kerosene

Generally, kerosene is taxed at 24.4 cents per gallon unless a reduced rate applies. Cite: IRC §§ 4081(a)(2)(A)(iii) and 4081(a)(2)(B).

Noncommercial Aviation

For kerosene removed directly from a terminal into the fuel tank of an aircraft for use in nonexempt, noncommercial aviation, the tax rate is 21.9 cents per gallon. Cite: IRC §§ 4081 (a)(2)(C) and 4081(a)(2)(B). The rate of 21.9 also applies if kerosene is removed into any aircraft from a qualified refueler truck, tanker, or tank wagon that is loaded with the kerosene from a terminal that is located within an airport. The airport terminal does not need to be a secured airport terminal for this rate to apply. However, the refueler truck, tanker, or tank wagon must meet the requirements discussed under Certain Refueler Trucks, Tankers, and Tank Wagons, Treated as Terminals, later.

Commercial Aviation

For kerosene removed directly into the fuel tank of an aircraft for use in commercial aviation, the rate of tax is 4.4 cents per gallon if the requirements discussed under Rate of Tax/Commercial Aviation are met. For kerosene removed into an aircraft from a qualified refueler truck, tanker, or tank wagon, the 4.4 rate applies only if the truck, tanker, or tank wagon is loaded at a terminal that is located in a secured area of the airport. Reference Terminal Located within a Secured Area of an Airport, later.

Foreign Trade or State and Local Government Use

For kerosene removed directly into the fuel tank of an aircraft for a use exempt from tax under section 4041(c), such as use for the exclusive use of a state or local government, the rate of tax is 0.1 cents per gallon for the LUST tax. However, LUST does not apply to kerosene used in foreign trade and kerosene destined for export.

The exemption (a partial exemption) applies to exempt uses in which the removals are from a qualifying refueler truck, tanker, or tank wagon loaded at a terminal located within a secured area of an airport. See Terminal Located within a Secured Area of an Airport, later. In addition, the operator must provide the **position holder** with a certificate similar to Model Certificate K, located in Appendix A. The position holder is liable for the LUST tax of 0.1 cents per gallon. Cite: Manufacturers and Retailers Excise Taxes Reg. § 48.4081-2(c)(1).

Certain Refueler Trucks, Tankers, and Tank Wagons Treated as Terminals

For purposes of the tax imposed on kerosene for use in aviation removed directly into the fuel tank of an aircraft for use in commercial aviation, certain refueler trucks, tankers, and tank wagons are treated as part of a terminal. Cite: IRC § 4081(a)(3). The carriers are treated as a part of a terminal if the following conditions are met:

- Such terminal is located within a secure area of an airport. Cite: IRC § 4082(e).
- Any kerosene for use in aviation which is loaded in a truck, tanker, or tank wagon at a terminal is for delivery only into aircraft at the airport in which the terminal is located.
- Except in the case of exigent circumstances identified by the Secretary in regulations, no vehicle registered for highway use is loaded with kerosene for use in aviation at the terminal.
- The refueler truck, tanker, or tank wagon meets the following requirements of section 4081(a)(3)(B) which requires that the truck, tanker, or wagon:
    1. Has storage tanks, hose, and coupling equipment designed and used for fueling aircraft,
    2. Is not registered for highway use, and
    3. Is operated by the terminal operator or a person that makes a daily accounting to the terminal operator of each delivery of fuel from the refueler truck, tanker, or tank wagon. Under section 4201(d), information reporting is required by terminal operators regarding this provision. Cite: IRC § 4081(a)(3)(C). (Note that until the format of this information reporting is issued, taxpayers are required to retain records regarding the daily accounting, but are not required to report such information.)

Rate of Tax

The following table summarizes the current tax rates on aviation fuel. Taxable sales of aviation fuel are entered on IRS No. 69 of Form 720, unless a sale was for use by the buyer in commercial aviation, which is reported on IRS No. 77. Aviation fuel used in exempt uses (other than foreign trade or export) is reported on IRS No. 111.

For Use In:	IRS No.	Tax Rate:
Commercial Aviation	077	.044
Noncommercial Aviation	069	.219
Fuel Used for exempt uses (other than foreign trade or export)	111	.001

Commercial Aviation

If kerosene is removed directly into the fuel tank of an aircraft for use in commercial aviation, the operator of the aircraft is liable for the tax on the removal at the rate of 4.4 cents per gallon. Cite: IRC § 4081(a)(4).

For the aircraft operator to be liable for the .044 rate, the position holder must meet the following requirements:

- Is a taxable fuel registrant under section 4101,
- Has an unexpired certificate (a model certificate is shown in the Appendix as Model Certificate K) from the operator of the aircraft, and
- Has no reason to believe any of the information in the certificate is false.

Cite: Notice 2005-4, 2005-1 C.B. 289.

The position holder is also not liable for the tax in a **flash title transaction** as described in Notice 2005-62, Section 6, paragraph (a)(2), if certain conditions are met. In a flash title transaction, the position holder sells the kerosene to a wholesale distributor (reseller) that in turn sells the kerosene to the aircraft operator as the kerosene is being removed from a terminal into the fuel tank of an aircraft. In this case, the position holder will be treated as having a certificate from the operator of the aircraft if:

- The aircraft operator puts the reseller's name, address, and EIN on the certificate in place of the position holder's information; and
- The reseller provides the position holder with a statement of the kerosene reseller.

The reseller statement is signed at the bottom or on the back of the certificate, under penalties of perjury, by a person with authority to bind the reseller. In addition, the reseller statement must contain the reseller's name, address, and employer identification number, the position holder's name, address, and employer identification number, along with a statement that the reseller has no reason to believe that any information in the accompanying aircraft operator's certificate is false. The certificate may be included as part of any business records normally used for a sale. See Model Certificate K located at Appendix A.

A certificate expires on the earliest of the following dates:

- The date 1 year after the effective date (not earlier than the date signed) of the certificate.
- The date the buyer provides the seller a new certificate or notice that the current certificate is invalid.
- The date the IRS or the buyer notifies the seller that the buyer's right to provide a certificate has been withdrawn.

The buyer must provide a new certificate if any information on a certificate has changed. The IRS may withdraw the buyer's right to provide a certificate if the buyer uses the kerosene for use in aviation to which a certificate relates other than as stated in the certificate.

Noncommercial Aviation

Commercial aviation means any use of an aircraft in a business of transporting persons or property for compensation or hire by air, unless properly allocable to any transportation exempt from the taxes imposed by sections 4261 and 4271, by reason of section 4281 or 4282, or by reason of subsection (h) or (i) of section 4261. Cite: IRC § 4083(b).

Commercial aviation does not include any of the following uses:

- Any use exclusively for the purpose of skydiving.

- Certain air transportation by seaplane.
- Any use of an aircraft owned or leased by a member of an affiliated group and unavailable for hire by nonmembers.
- Any use of an aircraft that has a maximum certificated takeoff weight of 6,000 pounds or less, unless the aircraft is operated on an established line. An aircraft is not considered operated on an established line at any time during which the aircraft is being operated on a flight the sole purpose of which is sightseeing.

The fuel used for the above uses is subject to the tax on fuel used in noncommercial aviation.

Exempt Uses

Kerosene removed directly into the aircraft for use in the following flights is taxed to the position holder at the 0.1 cents per gallon LUST tax:

- For use on a farm for farming purposes;
- For use in certain helicopter and fixed-wing air ambulances as described in sections 4261(f) and (g).
- For exclusive use by a nonprofit educational organization;
- For exclusive use of a state;
- For use in an aircraft owned by an aircraft museum;
- For use in military aircraft;
- Exclusive use by a qualified blood collectors organization.

Cite: Manufacturers and Retailers Excise Taxes Reg. § 48.4081-2(c)(1) and Notice 2005-80, Section 4, paragraph (d).

A certificate is required from the aircraft operator:

- To support aircraft operator liability for tax on removal of kerosene for use in aviation directly into the fuel tank of an aircraft in commercial aviation; or
- For all other exempt uses.

See Appendix A for a model of Certificate K.

Joint and Several Liability

Section 4103 states that in any case in which there is a willful failure to pay the tax imposed by section 4041(a)(1) or 4081, each person who is:

- an officer, employee, or agent of the taxpayer who is under a duty to assure the payment of such tax **and**
- who willfully fails to perform such duty, **or**
- who willfully causes the taxpayer to fail to pay such tax,

Shall be jointly and severally liable with the taxpayer for the tax to which such failure relates.

Thus, this is like the section 6672 penalty in that it allows the IRS to go beyond the entity liable for tax (such as a corporation) and obtain the tax from specified individuals who work for the entity. But note that unlike the 6672 penalty, section 4103 creates a liability for tax rather than impose a separate penalty.

Aviation Fuel Tax Credits and Refunds

Tax credits, filed on Form 4136, Credit for Federal Tax Paid on Fuels, and attached to the

income tax return at the end of the tax year, and refunds, filed on Form 8849, Claim for Refund of Excise Taxes, or as adjustments on the Form 720, Quarterly Federal Excise Tax Return, have special rules.

Ultimate Purchasers

The ultimate purchaser of kerosene used in commercial aviation (including foreign trade) and noncommercial aviation (other than nonexempt, noncommercial aviation and exclusive use by a state, political subdivision of a state, or the District of Columbia) is eligible to make a claim for credit or refund if the ultimate purchaser certifies that the right to make the claim has not been waived. Generally, the ultimate purchaser is the aircraft operator.

The following are the nontaxable uses of kerosene for which a credit or refund may be allowable to the ultimate purchaser:

- On a farm for farming purposes.
- In foreign trade.
- Certain helicopter and fixed-wing aircraft uses as described is section 4261(f) and (g).
- Exclusive use by a qualified blood collector organization.
- Exclusive use by a nonprofit educational organization.
- In an aircraft or vehicle owned by an aircraft museum.
- In military aircraft.

On a Farm for Farming Purposes

Custom application of fertilizer and pesticide.

Fuel used on a farm for farming purposes includes fuel used in the application of fertilizer, pesticides, or other substances, including aerial applications. Generally, the applicator is treated as having used the fuel on a farm for farming purposes. For kerosene used in aviation, the ultimate purchaser may make the claim or waive its right to make the claim to the registered ultimate vendor.

Fuel used between airfield and farm.

Fuel used by an aerial applicator for the direct flight between the airfield and one or more farms is treated as a farming purpose.

Kerosene for Use Partly in Commercial Aviation and Partly in Nonexempt Noncommercial Aviation.

If fuel is used partly for use in commercial aviation and partly for use in nonexempt, noncommercial aviation, the operator may identify, either at the time of purchase or after the kerosene has been used, the amount that will be (or has been) used in commercial aviation. At the same time, the operator would either make the claim or waive the right to make the claim for credit or refund of the kerosene for use in commercial and nonexempt, noncommercial aviation.

If the operator does not identify the amount of kerosene that will be (or has been) used in commercial aviation, the operator may provide a certificate to the ultimate vendor similar to Model Certificate Q located in Appendix A. For kerosene purchased with the certificate, used in commercial aviation, and taxed at $.244 per gallon, use of the certificate will be treated as a waiver of the right to claim a credit or refund for the $.025 per gallon part of the tax. The ultimate vendor may make this claim. The operator may make a claim for the $.175 per gallon of the kerosene, but cannot waive the right to make the claim for the $.175 per gallon.

Sales by Registered Ultimate Vendors

Kerosene for Use in Commercial Aviation or Noncommercial Aviation

The registered ultimate vendor of kerosene for use in commercial aviation (other than foreign trade) or noncommercial aviation (other than nonexempt, noncommercial aviation and exclusive use by a state, political subdivision of a state, or the District of Columbia) may make this claim if the ultimate purchaser waives its right to the credit or payment by providing the registered ultimate vendor with a waiver. A sample waiver is included as Model Waiver L, located in Appendix A. The registered ultimate vendor must have the waiver at the time the credit or payment is claimed.

Noncommercial aviation means any use of an aircraft not described as commercial aviation. For the definition of commercial aviation, see IRC § 4083(b).

Kerosene for Use in Nonexempt, Noncommercial Aviation

Only the registered ultimate vendor may claim a credit or payment for sales of kerosene for use in nonexempt, noncommercial aviation. The ultimate vendor must be registered by the IRS (activity letter UA) and have the required certificate from the ultimate purchaser. A sample certificate is included as Model Certificate Q in Appendix A. The registered ultimate vendor must have the certificate at the time the credit or payment is claimed. These claims are for the difference between the over the road rate of .244 cents per gallon and the noncommercial rate of .219 cents per gallon.

Kerosene for Use in Aviation by a State or Local Government

Only the registered ultimate vendor may claim a credit or payment for sales of kerosene for use in aviation to a state or local government for its exclusive use (including essential government use by an Indian tribal government). The kerosene for use in aviation must be purchased by the state without the use of a credit card in order for the ultimate vendor to make the claim. The ultimate vendor must be registered by the IRS (activity letter UV) and have the required certificate from the ultimate purchaser. A sample certificate is included as Model Certificate P in Appendix A. The registered ultimate vendor must have the certificate at the time the credit or payment is claimed.

Credit Card Purchases

If taxed kerosene for use in aviation is purchased with a credit card issued to a state, the person who extended credit to the state (the credit card issuer) is treated as the person that paid the tax. The credit card issuer may make a claim for credit or refund if the credit card issuer:

- Is registered by the IRS,
- Has established that the amount of tax has not been collected from the person who purchased the kerosene, or has obtained written consent from the ultimate purchaser to the allowance of the credit or refund, and
- Has repaid or agreed to repay the amount of the tax to the ultimate vendor, has obtained the written consent of the ultimate vendor to the allowance of the credit or refund, or has made arrangements which provide the ultimate vendor with reimbursement of the tax.

If the requirements above are not met by the credit card issuer, the credit card issuer must collect the tax from the ultimate purchaser. In this case, only the ultimate purchaser may make the claim for credit or refund of the tax.

Cite: IRC §§ 6416(a)(4)(B) and 6427(l)(5)(D)

Summary Table of Claims

AG = aviation gasoline
AF = aviation fuel

Ultimate Purchaser Claim	Ultimate Vendor Claim	Type Use	Type of Claim Allowable for Aviation Gasoline (AG) or Aviation Fuel (AF)
AG (credit only); AF	AF (Waiver L)	1	On a farm for farming purposes
AG or AF		2	Off-highway business use (Fuel used in a APU)
AG or AF		3	Export; claimants must include proof of export.
AG or AF	AF (Waiver L)	9	In Foreign Trade
AG or AF	AF (Waiver L)	10	Certain Helicopter and fixed wing aircraft
	AF (Waiver L)	11	Exclusive use by a qualified blood collector organization
	AG(Certificate M) or AF (Waiver L)	13	Exclusive use by a nonprofit educational organization
	AG(Certificate M) or AF (Certificate P)	14	Exclusive use by a state, political subdivision of a state or the District of Columbia
AG or AF	AG or AF (Waiver L)	15	In an aircraft owned by an aircraft museum
AG or AF	AG or AF (Waiver L)	16	In military aircraft
AF	AF (Waiver L)	-	Aviation fuel used in Commercial Aviation taxed at 24.4 cents per gallon
AF	AF (Waiver L)	-	Aviation fuel used in Commercial Aviation taxed at 21.9 cents per gallon
	AF (Certificate Q)	-	Aviation fuel used in Non-Commercial Aviation taxed at 24.4 cents per gallon
AG		-	Aviation Gasoline used in Commercial Aviation taxed at .194 cents per gallon

(The table above shows the types of claims that can be filed. The claim types are either Ultimate Purchaser Claims or Ultimate Vendor claims. Ultimate Purchaser Claims show in the first column. Ultimate Vendor claims are in the second column. AG indicates that the claim is for Aviation Gasoline and AF for Aviation Fuel. The type use is shown in the third column and the fourth column indicates what type of use is allowed for that type of claim.)

Note: When aviation fuel is removed directly into the fuel tank of an aircraft at

an airport terminal for commercial aviation or for a nontaxable uses such as: use on a farm, for use in foreign trade; for use in certain helicopter and fixed wing air ambulance services; for use other than as a fuel in the propulsion engine of an aircraft; for the exclusive use of a qualified blood collector organization; for the exclusive use of a nonprofit organization; for the exclusive use of a state, for use in an aircraft owned by an aircraft museum; for use in military aircraft; or for use in commercial aviation (other than foreign trade) the aircraft operator buying the fuel must provide the seller a copy of Certificate K to certify the use for which the fuel is being purchased.

See Appendix A for examples of the certificates or waivers referenced above.

Potential Audit Issues

Potential audit issues with aviation gasoline and aviation fuel are noted below.

Claims Filed for Aviation Fuel Used in Aircraft Power Units (APUs)

The Office of Chief Counsel issued a Memorandum on April 9, 2007, in which they offered legal advice stating that the fuel consumed in an aircraft APU is an exempt use of aviation fuel. Accordingly, we are now receiving claims for refund and credit for the gallons consumed in APUs. [Note that this legal memorandum is not citable as authority but may assist you in understanding what legal sources and reasoning would be used by the IRS or examiner if presented with a similar question.]

Fuel Used in Foreign Trade

If an aircraft that departs from a city in the United States lands in another city in the United States and then departs from the second city and lands in a foreign country, the aircraft is considered to be engaged in foreign trade for all of the flight segments so long as at least one individual flew from the first city to the final foreign destination on the aircraft. Once an aircraft is actually engaged in foreign trade, it remains engaged even though it makes intermediate stops in the United States. Cite: Rev. Rul. 2002-50, 2002-32 I.R.B., 292.

Example:

An aircraft flies from San Francisco to New York. After refueling and exchanging passengers in New York, the aircraft continues to London, England. So long as one passenger is booked on the flight pattern flown by the aircraft, in this case, San Francisco to New York to London, and none of the stopovers exceed the 12 hour rule, then all the fuel used by the aircraft on the flight pattern is considered as used in a foreign trade. Therefore, the flight from San Francisco to New York and the flight from New York to London are considered to be in foreign trade.

Sales of Fuel for Commercial Aviation on which Tax was Paid at the Noncommercial Aviation Rate

Taxpayers frequently dispute whether a particular flight is being flown in commercial aviation or noncommercial aviation. Claims are filed for refund of the difference in tax rates between the purchased rate of noncommercial aviation and the use rate of commercial aviation when no liability for transportation taxes imposed on commercial aviation is being reported on Form 720. This may or may not be allowable. For further guidance refer to Rev. Rul. 79-364, 1979-2 C.B. 366.

Improper Credit or Refund Claims

In addition, this includes multiple claims for the same fuel that are filed on Form 8849, Form 720, Form 4136, and or taken as blind credits in the workpapers used to prepare the gallons reported on Form 720.

Fuel Purchased at a Foreign Location

Taxpayers may include fuel purchased at a foreign location in claims for fuel used in a foreign trade or for fuel consumed in an APU. Since no U.S. Federal excise tax has been imposed on fuel purchased at a foreign location, the claimant is receiving a refund of taxes not previously imposed.

Failure to Include a Credit or Refund Received In Gross Income

Since credits and refunds may be received outside of the normal accounting year and/or method of receiving income of the recipient, the recipient may fail to include the money received in gross income. An income tax adjustment is due if the claimant has included the amount as an expense deduction and reduced his or her income tax liability. In this case, an income tax referral would be warranted.

Examination Techniques

Because the federal excise tax (FET) for aviation fuel is imposed on the position holder or in some cases the end user, there is a potential for many persons to incur this liability. A consideration is to be made of the items listed below during an examination.

Position Holder

1. The required periodic compliance checks of Form 637 registrants provide an opportunity to find out to whom a registrant has been selling aviation fuel tax-free. Check for sales for use in foreign trade (see #4 below)
2. If the position holder does not have a Form 637 registration then you have taxable above the rack transactions.
3. If tax-free aviation fuel sales were made, verify that the sales were made to registered purchasers and the sales were accompanied by appropriate exemption or waiver certificates. You may have an issue with any purchaser who is purchasing fuel tax exempt for use in commercial aviation if the purchaser is not registered. Be particularly aware of who is liable for the tax, the position holder or the aircraft operator?
4. Check for large bulk sales. Follow through to the purchaser to ensure the purchaser is registered.
5. Inspect the retained copy or copies of the position holder's state returns when appropriate.
6. Make a secondary FET computation by using the position holder's state returns and total pump reading sales. If the position holder is selling in more than one state, check the position holder's returns for all states.
7. Determine if (1) the state allows an evaporation deduction and (2) if an evaporation deduction has been entered on the Federal return.
8. Determine whether the business or owner(s) operate any aircraft. If so, determine whether an issue with either transportation of persons or property is present.

End User

1. Determine if the End User has a 637 registration. The required periodic compliance checks of Form 637 registrants provide an opportunity to find out if a registrant has been purchasing aviation fuel at reduced rates for use in commercial aviation, in foreign trade, or for other exempt purposes.
2. If the End User has a 637 registration, check all claims being filed.

3. If the End User has a 637 registration, and is filing claims on fuel used in commercial aviation, check to make sure tax was actually imposed on this fuel. The Taxpayer may be filing claims for fuel purchased tax exempt.
4. A 637 registrant can purchase fuel for use in commercial aviation and is then liable for the tax on those purchases. If this is the case, check to ensure the Taxpayer is paying and reporting the tax on Form 720 line 77 instead of filing a claim on Form 720, Schedule C.
5. Inspect purchase invoices for tax-paid or tax-free purchases and note where the fuel is purchased.
6. If the Taxpayer is claiming fuel used in commercial aviation, check to make sure the claim does not include fuel purchased tax exempt,
7. Determine how the information on use of the aviation fuel is being recorded.
8. Inspect retained copies of the user's state returns if applicable.
9. While inspecting the purchase invoices determine whether the supplier has passed on these taxes to the End User. If the taxes have not been passed on you may consider auditing the supplier since this may indicate that the supplier is not paying the tax.
10. When inspecting fuel claims for aviation fuel used in an APU.
    a. Ensure that none of the fuel from a claim involving fuel used in foreign trade or that was purchased at a foreign location is being included in the claim.
    b. Make sure the fuel used in the APU has been calculated on the actual burn rate of the APU. These records are available and should be requested to substantiate any claims relating to the fuel used in the APU.

If the state's fuel records are available, they should periodically be checked against the annual listing of Form 720 filers. A computer audit specialist could be of assistance in accomplishing this task or it can be done manually. Discrepancies may indicate a delinquent or incorrect Form 720 return.

Appendix A

Summary of Model Certificates

Model Certificate	Title	Page
K	Certificate of Person Buying Kerosene for Use in Aviation for Commercial Aviation for Nontaxable Use	115
L	Waiver for Use by Ultimate Purchasers of Kerosene for Certain uses in Aviation	116
M	Certificate for State Use or Nonprofit Educational Organization Use	117
P	Certificate of State Use	118
Q	Certificate of Ultimate Purchaser of Kerosene for Use in Nonexempt, Noncommercial Aviation	119

(The table above shows the type of model certificate that is applicable in the first column. The second column shows the certificate title and the third column shows the page in the Audit Technique Guide where the model certificate can be locate. A PDF version can be located at PUB 510 (PDF)).

An alternative text version of Publication 510 can be located at Alternative Text.

Model Certificate K

CERTIFICATE OF PERSON BUYING KEROSENE FOR USE IN AVIATION FOR COMMERCIAL AVIATION OR NONTAXABLE USE

(To support operator liability for tax on removals of kerosene for use in aviation directly into the fuel tank of an aircraft in commercial aviation pursuant to §4081 of the Internal Revenue Code or to support a tax rate of zero under §4041(c) pursuant to §§4041(c) and 4082)

Name, Address, and Employer Identification Number of position holder:

The undersigned aircraft operator ("Buyer") hereby certifies the following under the penalties of perjury:

The kerosene for use in aviation to which this certificate relates is purchased (check one): for use on a farm for farming purposes; for use in foreign trade (reciprocal benefits required for foreign registered airlines); for use in certain helicopter and fixed-wing air ambulance uses; for use other than as a fuel in the propulsion engine of an aircraft; for the exclusive use of a qualified blood collector organization; for the exclusive use of a nonprofit educational organization; for the exclusive use of a state; for use in an aircraft owned by an aircraft museum; for use in military aircraft; or for use in commercial aviation (other than foreign trade).

With respect to kerosene for use in aviation purchased after June 30, 2005, for use in commercial aviation (other than foreign trade), Buyer's registration number is . Buyer's registration has not been suspended or revoked by the Internal Revenue Service.

This certificate applies to the following (complete as applicable):

1. This is a single purchase certificate:Invoice or delivery ticket number
2. Number of gallons

This is a certificate covering all purchases under a specified account or order number:

1. Effective date:
2. Expiration date: (period not to exceed 1 year after the effective date)
3. Buyer's account number:

Buyer agrees to provide the person liable for tax with a new certificate if any information in this certificate changes.

If the kerosene for use in aviation to which this certificate relates is being bought for use in commercial aviation (other than foreign trade), Buyer is liable for tax on its use of the fuel and will pay that tax to the government.

If Buyer sells or uses the kerosene for use in aviation to which this certificate relates for a use other than the use stated above, Buyer will be liable for tax.

Buyer understands that it must be prepared to establish by satisfactory evidence the purpose for which the fuel purchased under this certificate was used.

Buyer has not been notified by the Internal Revenue Service that its right to provide a certificate has been withdrawn. If Buyer violates the terms of this certificate, the Internal Revenue Service may withdraw Buyer's right to provide a certificate.

The fraudulent use of this certificate may subject Buyer and all parties making any fraudulent use of this certificate to a fine or imprisonment, or both, together with the costs of prosecution.

Printed or typed name of person signing:
Title of person signing:
Name of Buyer:
Employer identification number:
Address of Buyer:
Signature and date signed:

Model Waiver L

WAIVER FOR USE BY ULTIMATE PURCHASERS OF KEROSENE FOR CERTAIN USES IN AVIATION
(To support vendor's claim for a credit or payment under §6427(l)(4)(C)(i) of the Internal Revenue Code)

Name, Address, and Employer Identification Number of Ultimate Vendor
The undersigned ultimate purchaser ("Buyer") hereby certifies the following under penalties of perjury:

A. The kerosene to which this waiver relates is purchased for--(check one):
    1. Use on a farm for farming purposes,
    2. Use in foreign trade (reciprocal benefits required for foreign registered airlines),
    3. Use in certain helicopter and fixed-wing air ambulance uses,
    4. The exclusive use of a qualified blood collector organization,
    5. The exclusive use of a nonprofit educational organization,
    6. Use in an aircraft owned by an aircraft museum,
    7. Use in military aircraft, or
    8. Use in commercial aviation (other than foreign trade).
B. B. This waiver applies to the following (complete as applicable):
    This is a single purchase waiver:
    1. Invoice or delivery ticket number
    2. Number of gallons
    This is a waiver covering all purchases under a specified account or order number:
    1. Effective date:
    2. Expiration date: (period not to exceed 1 year after the effective date)
    3. Buyer's account number:

- Buyer will provide a new waiver to the vendor if any information in this waiver changes.
- If Buyer uses the kerosene for use in aviation to which this waiver relates for a use other than the use stated above, Buyer will be liable for tax.
- Buyer understands that by signing this waiver, Buyer gives up its right to claim any credit or payment for the kerosene for use in aviation used in a nontaxable use.
- Buyer acknowledges that it has not and will not claim any credit or payment for the kerosene for use in aviation to which this waiver relates.
- Buyer understands that the fraudulent use of this certificate may subject Buyer and all parties making such fraudulent use of this certificate to a fine or imprisonment, or both, together with the costs of prosecution.

Printed or typed name of person signing:
Title of person signing:
Name of Buyer:

Employer identification number:
Address of Buyer:
Signature and date signed:

Model Certificate M

CERTIFICATE FOR STATE USE OR NONPROFIT EDUCATIONAL ORGANIZATION USE
(To support vendor's claim for a credit or payment under §6416(a)(4) of the Internal Revenue Code)

Name, Address, and Employer Identification Number of Ultimate Vendor:

The undersigned ultimate purchaser ("Buyer") hereby certifies the following under the penalties of perjury:
Buyer will use the gasoline or aviation gasoline to which this certificate relates (check one):
For the exclusive use of a state or local government; or
For the exclusive use of a nonprofit educational organization.
This certificate applies to the following (complete as applicable):
This is a single purchase certificate:

1. Invoice or delivery ticket number
2. Number of gallons

If this is a certificate covering all purchases under a specified account or order number, check here and enter:

1. Effective date:
2. Expiration date:
   (period not to exceed 1 year after effective date)
3. Buyer's account or order number:

Buyer will provide a new certificate to the vendor if any information in this certificate changes.
Buyer understands that by signing this certificate, Buyer gives up its right to claim any credit or payment for the gasoline or aviation gasoline to which this certificate relates.
Buyer acknowledges that it has not and will not claim any credit or payment for the gasoline or aviation gasoline to which this certificate relates.
Buyer understands that the fraudulent use of this certificate may subject Buyer and all parties making such fraudulent use of this certificate to a fine or imprisonment, or both, together with the costs of prosecution.

Printed or typed name of person signing:
Title of person signing:
Name of Buyer:
Employer identification number:
Address of Buyer:
Signature and date signed:

Model Certificate P

CERTIFICATE OF STATE USE

(To support vendor's claim for credit or payment under section 6427 of the Internal Revenue Code)

Name, Address, and Employer Identification Number of Vendor

The undersigned buyer ("Buyer") hereby certifies the following under penalties of perjury:

A. Buyer will use the diesel fuel or kerosene to which this certificate relates for the exclusive use of a state or local government, or the District of Columbia.
B. This certificate applies to the following (complete as applicable):
    1. If this is a single purchase certificate, check here and enter:
        a. Invoice or delivery ticket number:
        b. Number of gallons:
    2. If this is a certificate covering all purchases under a specified account or order number, check here and enter:
        a. Effective date:
        b. Expiration date: (period not to exceed 1 year after effective date)
        c. Buyer's account or order number:

- Buyer will provide a new certificate to the vendor if any information in this certificate changes.
- If Buyer uses the diesel fuel or kerosene to which this certificate relates for a purpose other than stated in the certificate, Buyer will be liable for any tax.
- Buyer acknowledges that it has not and will not claim any credit or payment for the diesel fuel or kerosene to which this certificate relates.
- Buyer understands that the fraudulent use of this certificate may subject Buyer and all parties making such fraudulent use of this certificate to a fine or imprisonment, or both, together with the costs of prosecution.

Printed or typed name of person signing:
Title of person signing:
Name of Buyer:
Employer identification number:
Address of Buyer:
Signature and date signed

Model Certificate Q

CERTIFICATE OF ULTIMATE PURCHASER OF KEROSENE FOR USE IN NONEXEMPT, NONCOMMERCIAL AVIATION

(To support vendor's claim for credit or payment under section 6427(l)(4)(C)(ii) of the Internal Revenue Code)

Name, Address, and Employer Identification Number of Ultimate Vendor:

The undersigned ultimate purchaser ("Buyer") hereby certifies the following under penalties of perjury:

A. The kerosene to which this certificate relates is purchased for a nonexempt use in noncommercial aviation.
B. This certificate applies to the following (complete as applicable):
    1. If this is a single purchase certificate, check here and enter:
        a. Invoice or delivery ticket number:

b. Number of gallons:

2. This is a certificate covering all purchases under a specified account or order number:
   a. Effective date:
   b. Expiration date: (period not to exceed 1 year after effective date)
   c. Buyer's account number:

- Buyer will provide a new certificate to the vendor if any information in this certificate changes.
- If Buyer uses the kerosene to which this certificate relates for a use other than the nontaxable use stated above, Buyer will be liable for tax.
- Buyer understands that the fraudulent use of this certificate may subject Buyer and all parties making such fraudulent use of this certificate to a fine or imprisonment, or both, together with the costs of prosecution.

Printed or typed name of person signing:
Title of person signing:
Name of Buyer:
Employer identification number:
Address of Buyer:
Signature and date signed:

Appendix B

Major Canadian Cities within the 225 Mile Zone

- Baie Comeau, Quebec
- Brandon, Manitoba
- Calgary, Alberta
- Castlegar, British Columbia
- Charlottetown, PEI
- Comox, British Columbia
- Cranbrook, British Columbia
- Earlton, Ontario
- Forestville, Quebec
- Fredericton, New Brunswick
- Gaspe, Quebec
- Halifax, Nova Scotia
- Hamilton, Ontario
- Lamloops, Br. Columbia
- Kapuskasing, Ontario
- Kelowna, Br. Columbia
- Kenora, Ontario
- Lac du Bonnet, Manitoba
- Lethbridge, Alberta
- Little Grand Rapids, Manitoba
- London, Ontario
- Matane, Quebec
- Medicine Hat, Alberta
- Moncton, New Brunswick
- Mont Joli, Quebec
- Montreal, Quebec
- New Glasgow, Nova Scotia
- North Bay, Ontario
- Ottawa, Ontario
- Manitoba Penticton, Br. Col

- Port Hardy, Br. Col.
- Powell River, Br. Col.
- Quebec, Quebec
- Red Lake, Ontario
- Regina, Saskatchewan
- Rimouski, Quebec
- Saguenay, Quebec
- St. John, New Brunswick
- Saskatoon, Saskatchewan
- Sault Ste. Marie, Ontario
- Sept Isles, Quebec
- Sioux Lookout, Ontario
- Sudbury, Ontario
- Summerside, PEI
- Swift Current, Saskatchewan
- Thunder Bay, Ontario
- Timmins, Ontario
- Toronto, Ontario
- Vancouver, British Columbia
- Victoria, British Columbia
- Williams Lake, British Columbia
- Windsor, Ontario
- Winnipeg, Manitoba
- Yarmouth, Nova Scotia

Major Mexican Cities within the 225 Mile Zone

- Canarea, Sonora
- Chihuahua, Chihuahua
- Ciudad Jauarez, Chihuahua
- Ciudad Victoria, Tamaulipas
- Ensenada, Baja California
- Hermosilo, Sonora
- Matamoros, Coahuila
- Mexicali, Baja California
- Moncolova, Coahuila (Monterrey)
- Monterrey, Nuevo Leon
- Nogales, Sonora
- Nuevo Casas Grandes, Chihuahua
- Nuevo Laredo, Tamaulipas
- Piedras Negras, Coahuila
- Peynosa, Tamaulipas
- Tijiuana, Baja California