

Rev. Rul. 68-256

1968-1 C.B. 489

IRS Headnote

The Internal Revenue Service discusses the applicability of the tax on the transportation of persons by air, imposed by section 4261 of the Internal Revenue Code of 1954, where a seller of aircraft provides demonstration flights for prospective purchasers.

Full Text

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Advice has been requested on the applicability of the excise tax on the transportation of persons by air to payments made in connection with flights for demonstration purposes under the circumstances described below.

M company is engaged in selling aircraft designed for private use by business firms in transporting executive personnel. The aircraft are not the limited capacity type coming within the exemption from transportation tax provided by section 4263(d) of the Internal Revenue Code of 1954. As a customary and necessary sales technique, M company offers flights for purposes of demonstrating this type of aircraft to prospective purchasers.

The demonstration flights are scheduled so as to accommodate the prospective purchasers; the route and duration of the flights being determined by their requests. In some instances, M company will charge the prospective purchaser for the cost of the demonstration flight; in other instances no charge is made. In certain other instances the prospective purchaser, as a matter of business policy, will reimburse M company for the cost of the demonstration flight even though M company would not have charged the prospect. If an aircraft is purchased, M company applies as a credit against the purchase price of the aircraft an amount equal to any payment made by the prospective purchaser for the demonstration.

If M company does not have a demonstration aircraft in stock, it leases one from X company under either of two types of arrangements. On some occasions, M company leases an aircraft from X company for a lump sum and operates the aircraft with its own crew, such arrangement being referred to as a 'dry lease.' On other occasions, M company leases an aircraft from X company which includes the use of a crew supplied by X company, such arrangement being referred to as a 'wet lease.'

Section 4261 of the Code imposes a tax on amounts paid within the United States for taxable transportation (or without the United States if the taxable transportation begins and ends in the United States) and on amounts paid for seating or sleeping accommodations in connection with such transportation. The tax imposed by this section (except in certain cases not here relevant) is to be paid by the person making payment for the service.

Section 49.4261-1(c) of the Facilities and Services Excise Tax Regulations provides that the purpose of the transportation, whether business or pleasure, is immaterial. It is not necessary that the transportation be between definite points. If not otherwise exempt, a payment for continuous transportation beginning and ending at the same point is subject to the tax.

Section 49.4261-7(h) of the regulations provides that an amount paid for the charter of an aircraft for transportation of persons, where no charge is made by the charterer to the persons transported, is subject to tax if the amount paid for the charter represents a per capita charge of more than 60 cents for each person actually transported. That section further provides that the charterer of an aircraft who sells transportation

to other persons must collect and account for the tax with respect to all amounts paid to him for transportation which are in excess of 60 cents; and that in such case, no tax will be due on the amount paid for the charter of the aircraft but it shall be the duty of the owner of the aircraft to advise the charterer of his liability for collecting and accounting for the tax.

When M company leases an aircraft under `dry lease' conditions, the lease payment is a payment for use of an aircraft which will be under the control of M company during the term of the lease. Consequently, the payment is a rental payment rather than a payment for taxable transportation. On the other hand, when M company leases an aircraft under `wet lease' conditions, control of the aircraft remains with X company because X's crew is responsible for operations of the plane during the term of the lease. Accordingly, the lease is in the nature of a charter arrangement of a type described in section 49.4261-7(h) of the regulations. See Revenue Ruling 60-311, C.B. 1960-2, 341, which discusses the different tax consequences resulting from a lease under which the lessor retains control of the aircraft and a lease under which control is transferred to the lessee.

The fact that the transportation of prospective purchasers by M company is for the purpose of demonstration does not remove such transportation from the scope of the tax imposed by section 4261 of the Code. Furthermore, even though M company does not charge the prospective purchaser for the transportation, or require the prospective purchaser to reimburse the M company for the cost of the flight, the fact remains that if a payment for taxable transportation was made, the voluntary nature of the payment does not affect the tax liability incurred.

When a prospective purchaser makes a payment to M company for a demonstration flight, the amount paid is an amount paid for taxable transportation. Under such circumstances the prospective purchaser is liable for the tax and M company is responsible for collecting and paying the tax to the Government. If M company had leased the aircraft from X company, then under these conditions, no tax is due on any amount paid by M company to X company for the lease of the aircraft.

If a prospective purchaser makes no payment for the demonstration flight, and M company uses its own plane or an aircraft obtained from X company under a `dry lease' arrangement, no transportation tax is due from any of the parties.

However, if M company leased an aircraft from X company under the `wet lease' arrangement, and the prospective purchaser makes no payment, M company is liable for the tax on amounts paid to X company for charter of the aircraft, and X company is responsible for collecting and paying the tax to the Government.