

NATA 2010  
Air Charter Summit

# Liability of Charter Operators for Payment of FET on Flights Sold Through Brokers



Presented by



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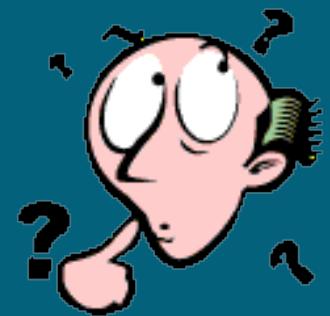
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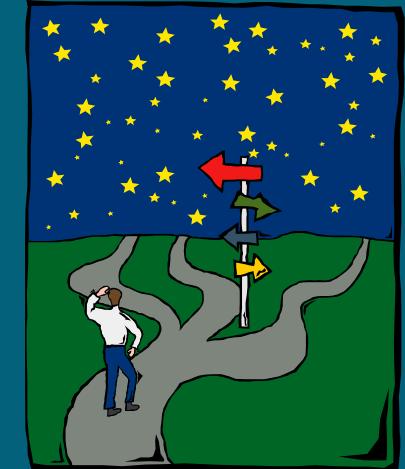
# Introduction

- FET issues must be considered by Part 135 operators every time they deal with a charter broker.
  - Who is responsible for collecting and remitting?
  - How is the decision made?
  - What is the risk if the IRS is not paid?
- How can Part 135 operators best protect themselves?



# Who is Responsible for Collecting and Remitting the FET?

- IT DEPENDS!!
- What is the broker's role?
  - Is it the 135 operator's agent?
  - Is it the customer's agent?
  - Is it the principal?
- How do you make the determination?
  - IRS analysis and/or DOT analysis?



# The Broker's Role: Agent of the Air Carrier

- What is its role?
  - Broker obtains customers on behalf of the 135 operator.
- IRS analysis of FET:
  - Brokers that are agents of the airline collect the FET from the pax and remit to the airline which then remits it to the IRS.
  - Examples:
    - Travel agencies under supervision and control of airline and not independently licensed as a broker
- Contract for transportation would be between 135 operator and passenger.
- Arrangement is also consistent with DOT's analysis of the "broker's" role.



# The Broker's Role: Agent of the Customer

- What is its role?
  - Broker acquires transportation on air carrier on behalf of pax.
- IRS analysis of FET:
  - Brokers that are agents of the customer collect the FET from the pax and remit to the airline which then remits it to the IRS.
- Contract for transportation would be between 135 operator and passenger.
- Arrangement is also consistent with DOT's analysis of the “broker’s” role.



# The Broker's Role: The Principal

- What is its role?
  - Broker has independent relationships with each of the 135 carrier and the pax to purchase and to sell, respectively, the charter transportation.
- IRS analysis of FET:
  - If the broker acts as a principal by purchasing and reselling transportation, the broker should collect and remit FET to the IRS based on what it charges the pax.
    - But if the broker is only an intermediary between the pax and the 135 carrier (i.e., it brings the 135 carrier and the pax together and they contract with each other), it is not a principal and not required to collect and remit FET.
    - The 135 carrier must advise the broker of its obligation to collect and remit the FET.
  - Unless the broker has DOT authority to act as an “indirect” air carrier (Part 380 public charter authority or otherwise), its actions are inconsistent with DOT requirements.



# The Broker's Role: The Real Problem

- BUT the practical lines that define the relationships in our industry are not as clear as the interpretations and guidance issued by the IRS.
- Some “brokers” are agents of the air carrier but they are nothing like travel agents in the airline industry.
- Many “brokers” collect and remit the FET based on the amount charged to the passenger, but they are not independently licensed.
  - IRS has repeatedly said that FAA’s classification of a flight is irrelevant to the applicability.
  - Is DOT’s classification of a “broker” relevant for purposes of determining which party should collect and remit FET?
    - Does it matter if DOT would consider the actions of the “broker” to be in compliance with DOT requirements?



# What Are the Risks?

- The party receiving the taxable transportation is obligated to pay the tax but the party providing the transportation is obligated to collect and remit it to the IRS.
- If the IRS is not paid:
  - It will look to the carrier providing the first segment of the taxable transportation.
  - If the failure to collect/pay was intentional, the party responsible for collection/remittance may be assessed a penalty equal to the tax.
    - This could include certain officers, employees or members of a company.
- It's usually years later when the IRS comes knocking at your door ...
- Is this how you want to spend your time?



# How Can the 135 Carrier Best Protect Itself?

- The safest and cleanest way for a 135 carrier to deal with the payment of the FET is for it to invoice the pax the full amount (including the amount to be paid to the broker) plus applicable FET.
  - The 135 carrier would collect, report and remit the FET to IRS.
  - The 135 carrier would pay the broker its “commission” or “fee.”
- If the pax ultimately has to pay the FET, aren’t we just talking about timing?
- But, just because something may make sense doesn’t mean people will go along with it.



# How Can the 135 Carrier Best Protect Itself?

- Responses to typical business issues raised by broker to justify doing it the old way:
  - Carrier Poaching Customer or Undercutting Price: Enter into non-circumvention agreement that identifies covered customers and term and contains penalties and right to specific performance.
  - Broker Doesn't Want Anyone to Know How Much It is Making: The only party that would know would be the 135 carrier and the non-disclosure element can be covered by an agreement (possibly part of the non-circ agr described above).
  - Desire for the Pax to Identify the Service With the Broker: Unfair and deceptive practice in violation of DOT statutory requirements.
  - Desire for Broker to Maintain the Relationship With the Pax: No problem. Only difference is that the invoice is issued by the 135 carrier and payment is made to the 135 carrier.



# How Can the 135 Carrier Best Protect Itself?

- If that doesn't work.....
- Have a clear agreement with broker regarding its obligation to collect and remit FET.
  - But how valuable is that agreement?
  - And does that get you off the hook with the IRS if the broker doesn't live up to its agreement?
- Request evidence of FET reporting and remittance
  - But that reflects the broker's past performance and may not even be complete.
- Request some form of collateral (performance bond, letter of credit, etc.).



# How Can the 135 Carrier Best Protect Itself?

- Collect and remit FET on the amount you are charging the broker.
- Advise the broker that it is responsible for ensuring that the IRS is paid the FET for the additional amount paid by the customer for the flight (i.e., the difference between what the broker paid and what the pax pays).
- But this raises some questions:
  - What are the procedures for doing this?
    - How would the IRS relate the 2 payments so it does not look to the 135 carrier for FET on the differential?
    - Could the IRS try to charge FET twice (i.e., once on the amount paid by the broker and once on the full amount paid by the pax)?



# How Can the 135 Carrier Best Protect Itself?

- Submit a request to the IRS for a revenue ruling?
- While this is a legal option, there are many reasons it may not be a practical option:
  - A DOT rule will be coming out dealing with brokers so the field will change.
  - Revenue rulings are tied directly to the exact facts presented to the IRS.
    - If there is anything in this industry that you can count on it is that you can't count on anything in this industry being exactly the same or exactly as you planned.
    - The value of a revenue ruling is likely not worth the time, effort and money it will cost to get one.



# How Can the 135 Carrier Best Protect Itself?

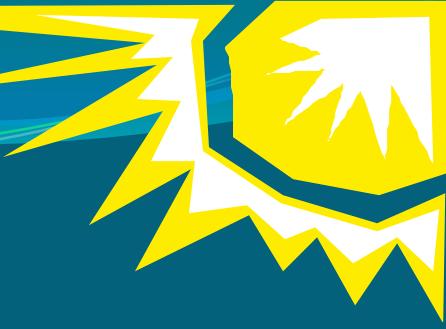
- Do your due diligence.
  - Know the parties
  - Get references
- Document each party's obligations.
- Educate yourself on the legal requirements but recognize that few arrangements fit neatly in the boxes drawn by the government.
- Do not leave your common sense at home.



# Conclusion

- FET issues in the charter broker area are not difficult when you look at them on paper.
  - Brokers that act as principals must collect and remit FET.
    - The 135 carrier must advise the broker of its obligation to collect and remit the FET to the IRS.
  - Brokers acting as agents of 135 carriers or as agents of pax must collect the FET from the pax and remit it to the 135 carrier and the 135 carrier must remit the FET to the IRS.
    - The 135 carrier should advise the broker of its obligation to collect and remit.
  - But, determining the capacity in which a broker is operating can be more difficult in the real world.
- Business issues may affect the structure of a relationship between a 135 carrier and the broker, it will not change the legal obligations.
- Don't take unnecessary risks.





Thank you

