16. Amounts paid for aircraft management services (sec. 13822 of the Senate amendment and sec. 4261 of the Code)

Present Law

Excise tax on taxable transportation by air

For domestic passenger transportation, section 4261 imposes an excise tax on amounts paid for taxable transportation. In general, for domestic flights, the tax consists of two parts: a 7.5 percent *ad valorem* tax applied to the amount paid and a flat dollar amount for each flight segment (consisting of one takeoff and one landing). "Taxable transportation" generally means transportation by air which begins and ends in the United States. The tax is paid by the person making the payment subject to tax and the tax is collected by the person receiving the payment. For commercial freight aviation, the *ad valorem* tax is 6.25 percent of the amount paid for transportation

In determining whether a flight constitutes taxable transportation and whether the amounts paid for such transportation are subject to tax, the Internal Revenue Service ("IRS") has looked at who has "possession, command, and control" of the aircraft based on the relevant facts and circumstances. [1185]

Applicability to aircraft management services

Generally, an aircraft management services company ("management company") has as its business purpose the management of aircraft owned by other corporations or individuals ("aircraft owners"). In this function, management companies provide aircraft owners, among other things, with administrative and support services (such as scheduling, flight planning, and weather forecasting), aircraft maintenance services, the provision of pilots and crew, and compliance with regulatory standards. Although the arrangement between management companies and aircraft owners may vary, it is our understanding that aircraft owners generally pay management companies a monthly fee to cover the fixed expenses of maintaining the aircraft (such as insurance, maintenance, and recordkeeping) and a variable fee to cover the cost of using the aircraft (such as the provision of pilots, crew, and fuel).

In March 2012, the IRS issued a Chief Counsel Advice determining that a management company provided all of the essential elements necessary for providing transportation by air and the owner relinquished possession, command and control to the management company. [1186] Thus, the management company was determined to be providing taxable transportation to the

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[1185] See, *e.g.*, Rev. Rul. 60-311, 1960-2 C.B. 341, which held that, since the company in question retains the elements of possession, command, and control of the aircraft and performs all services in connection with the operation of the aircraft, the company is, in fact, furnishing taxable transportation to the lessee; and the tax on the transportation of persons applies to the portion of the total payment which is allocable to the transportation of persons, provided such allocation is made on a fair and reasonable basis. If no allocation is made, the tax applies to the total payment for the lease of the aircraft.

[1186] CCA 2012-10026 (March, 2012).

owner and was required to collect the appropriate federal excise tax from the aircraft owner and remit it to the IRS. The Chief Counsel Advice resulted in increased audit activity by the IRS on aircraft management companies.

In May 2013, the IRS suspended assessment of the federal excise tax with respect to aircraft management services while it developed guidance on the tax treatment of aircraft management issues. In a 2015 opinion,[1187] an Ohio district court held that the existing revenue rulings (in effect for the tax period April 1, 2005, through June 30, 2009, the period that was the subject of the litigation) regarding the possession, command and control test, failed to provide precise and not speculative notice of a collection obligation as it related to whole-aircraft management contracts.[1188] As a result, the court ruled as a matter of law that because precise and not speculative notice was not received, the aircraft management company plaintiff did not have a collection obligation with respect to the Federal excise tax on payments received for whole-aircraft management services.

In 2017, the IRS decided not to pursue examination of the issue of whether amounts paid to aircraft companies by the owners or lessors of the aircraft are taxable until further guidance is made available. According to the IRS, for any exam in suspense the aircraft management fee issue was conceded and the taxpayers were notified accordingly.[1189] The IRS has not issued further guidance on this issue.

House Bill

No provision.

Senate Amendment

The Senate amendment exempts certain payments related to the management of private aircraft from the excise taxes imposed on taxable transportation by air. Exempt payments are those amounts paid by an aircraft owner for management services related to maintenance and support of the owner's aircraft or flights on the owner's aircraft. Applicable services include support activities related to the aircraft itself, such as its storage, maintenance, and fueling, and those related to its operation, such as the hiring and training of pilots and crew, as well as administrative services such as scheduling, flight planning, weather forecasting, obtaining insurance, and establishing and complying with safety standards. Aircraft management services also include such other services as are necessary to support flights operated by an aircraft owner.

[1187] *Netjets Large Aircraft Inc. v. United States*, 116 A.F.T.R. 2d. 2015-6776 (S.D. Ohio, 2015).

[1188] The district court held that such notice is required to persons having a deputy tax collection obligation under the rationale of the Supreme Court's holding in *Central Illinois Public Service Company v. United States*, 435 U.S. 21 (1978).

[1189] See also, Kerry Lynch, *IRS To Shelve Pending Audits on Aircraft Management Fees, AINonline (July 17, 2017)* http://www.ainonline.com/aviation-news/business-aviation/2017-07-17/irs-shelve-pending-audits-aircraft-management-fees.

Payments for flight services are exempt only to the extent that they are attributable to flights on an aircraft owner's own aircraft.[1190] Thus, if an aircraft owner makes a payment to a management company for the provision of a pilot and the pilot provides his services on the aircraft owner's aircraft, such payment is not subject to Federal excise tax. However, if the pilot provides his services to the aircraft owner on an aircraft other than the aircraft owner's (for instance, on an aircraft that is part of a fleet of aircraft available for third-party charter services), then such payment is subject to Federal excise tax.

The provision provides a pro rata allocation rule in the event that a monthly payment made to a management company is allocated in part to exempt services and flights on the aircraft owner's aircraft, and in part to flights on aircraft other than the aircraft owner's. In such a circumstance, Federal excise tax must be collected on that portion of the payment attributable to flights on aircraft not owned by the aircraft owner.

Under the provision, a lessee of an aircraft is considered an aircraft owner provided that the lease is not a "disqualified lease." A disqualified lease is any lease of an aircraft from a management company (or a related party) for a term of 31 days or less.

Effective date.−The provision is effective for amounts paid after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

Effective date.−The provision is effective for amounts paid after the date of enactment.

[1190] Examples of arrangements that cannot qualify a person as an "aircraft owner" include ownership of stock in a commercial airline and participation in a fractional ownership aircraft program. Ownership of stock in a commercial airline cannot qualify an individual as an "aircraft owner" of a commercial airline's aircraft, and amounts paid for transportation on such flights remain subject to the tax under section 4261. Similarly, participation in a fractional ownership aircraft program does not constitute "aircraft ownership" for purposes of this standard. Amounts paid to a fractional ownership aircraft program for transportation under such a program are exempt from the ticket tax under section 4261(j) if the aircraft is operating under subpart K of part 91 of title 14 of the Code of Federal Regulations ("subpart K"), and flights under such program are subject to both the fuel tax levied on non-commercial aviation an additional fuel surtax under section 4043 of the Code. A business arrangement seeking to circumvent that surtax by operating outside of subpart K, allowing an aircraft owner the right to use any of a fleet of aircraft, be it through an aircraft interchange agreement, through holding nominal shares in a fleet of aircraft, or any other arrangement that does not reflect true tax ownership of the aircraft being flown upon, is not considered ownership for purposes of the provision.