INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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Director
[Advisee's office]

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Years Involved:
Date of Conference:

Legend:

Taxpayer =

X =

Issue

Whether the Monthly Management Fees or the Variable Rate Fees, including the Additional Fees, paid to Taxpayer by aircraft owners are subject to the excise tax on amounts paid for taxable transportation under § 4261 of the Internal Revenue Code.

Conclusion

Both the Monthly Management Fees and the Variable Rate Fees, including the Additional Fees, paid to Taxpayer by aircraft owners are subject to the excise tax as amounts paid for taxable transportation under § 4261.

Facts

Taxpayer is an aircraft management company that manages and maintains aircraft for owners ("Aircraft Owners") who participate in its X program. A program participant purchases (from an entity related to taxpayer) an undivided interest in one or more of several types of aircraft. In the program, the Aircraft Owners are guaranteed a set number of hours of flight time based on their ownership interests.

Under a management agreement between Taxpayer and the Aircraft Owners, the owners are charged an hourly rate based on actual usage. The hourly rate is set in accordance with the costs of operating the aircraft and is adjusted to reflect changes in costs ("Variable Rate Fee"). Owners are also charged a monthly management fee, which covers the fixed costs of maintaining, servicing and repairing, overhauling, and storing the aircraft ("Monthly Management Fee"). In addition, the owners are, when necessary, charged additional charges, such as costs of complying with any airworthiness directives or new FAA requirements, air space fees, or costs of flight phone use, that are either included in the Variable Rate Fee or billed separately to the owners ("Additional Charges").

At the time an Aircraft Owner purchases an undivided interest in an aircraft, pursuant to a purchase agreement, a joint ownership agreement is executed by the owner and the other owners of undivided interests in the aircraft. Also pursuant to the purchase agreement, a management agreement is executed by the owner and Taxpayer; and a master interchange agreement is executed by the owner, the other owners of additional undivided interests in the aircraft, and the owners of undivided interests in other aircraft managed by Taxpayer.

Under the terms of the management agreement, Taxpayer is required to inspect, maintain, service, repair, overhaul, and test the aircraft so as to keep the aircraft in good operating condition as may be necessary to keep its airworthiness certification in good standing at all times. Taxpayer must maintain all records, logs, and other materials required by the Federal Aviation Administration ("FAA"). Taxpayer is also required, at its expense, to arrange for all-risk aircraft hull insurance and liability insurance naming Taxpayer and the Aircraft Owners as the insured parties. Taxpayer agrees to provide the management services for the Aircraft Owners' benefit, at the direction of the majority in accordance with the terms of the agreement. Under the agreement, representatives are appointed by the owners to make decisions on their behalf to the extent not otherwise provided for in the agreement.

Also under the management agreement, flight hours are allocated among the Aircraft Owners. In addition, Taxpayer must provide professionally trained and qualified pilots, hangar space, general storage space, tie-down as required, normal in-flight catering, and flight planning and weather services. Finally under the management

agreement, an owner's interest in an aircraft is transferable, but only to someone willing to enter into all of the foregoing agreements.

Under the X Program, Taxpayer must use reasonable efforts to provide an Aircraft Owner with its own aircraft, but the owner is not guaranteed flights in its aircraft. In the event that an owner's aircraft is not available, aircraft owned by other participants in the program are made available as replacement aircraft. If no program aircraft are available, then Taxpayer must provide the owner with the use of a suitable and comparable replacement aircraft from outside the program. Any replacement aircraft is treated as an owner's aircraft for purposes of determining the owner's use of allocated hours.

Law

Section 4261 imposes a tax on the amount paid for taxable transportation (as defined in § 4262) of any person.

Section 4262 defines "taxable transportation" as including transportation by air that begins in the United States and ends in the United States.

Section 4261(d) provides that, except as provided in § 4263(a) (not relevant here), taxes imposed by § 4261 shall be paid by the person making the payment subject to the tax.

Section 4291 provides that, except as otherwise provided in § 4263(a) (not relevant here), every person receiving any payment for taxable transportation on which a tax is imposed upon the payer thereof by § 4261 shall collect the amount of the tax from the person making the payment.

Section 49.4261-2(a) of the Facilities and Services Excise Taxes Regulations provides that the tax is measured by the total amount paid, whether at one time or at intervals during the transportation. However, where a payment covers charges for nontransportation services as well as for transportation, § 49.4261-2(c) provides that the charges for nontransportation services, such as charges for meals, hotel accommodations, etc., may be excluded in computing the tax payable, provided that the charges are (1) separable and (2) shown in exact amounts in the records pertaining to the transportation charge.

Section 49.4261-8 provides examples of payments not subject to tax. Section 49.4261-8(f) lists various miscellaneous charges that are not subject to tax if they are (1) separable from the payment for transportation and (2) shown in exact amounts in the records pertaining to the transportation charge. Among the listed charges are those

listed in § 49.4261-8(f)(4), which provides that the tax does not apply to miscellaneous charges for admissions, guides, meals, hotel accommodations, and similar nontransportation services, where the items are included in a lump sum payment for an all-expense tour.

Rev. Rul. 60-311, 1960-2 C.B. 341, concerns the applicability of the § 4261 tax to certain aircraft lease situations. The revenue ruling holds that where the owner of an aircraft leases it to others for air transportation of persons but retains possession, command, and control of the aircraft, the owner is furnishing a taxable transportation service within the meaning of § 4261. However, where the owner of the aircraft transfers the complete possession, command, and control of the aircraft to a lessee, the owner is not engaging in a taxable transportation service but is merely leasing its aircraft.

Rev. Rul. 68-256, 1968-1 C.B. 489, describes the tax consequences of leasing an aircraft under a “wet lease” arrangement and a “dry lease” arrangement. Under a wet lease, the lessor of the aircraft supplies the flight crew while under a dry lease, the lessee supplies the flight crew. The ruling holds that, because the lessee controls the flight crew, payments under a dry lease are rental payments rather than payments for air transportation. However, because the lessor controls the flight crew, payments under a wet lease are payments for air transportation.

Rev. Rul. 58-215, 1958-1 C.B., 439, involves the applicability of the § 4261 tax to payments made by a corporate owner of an aircraft to an aircraft company to service, maintain, overhaul, and operate for purposes of transporting the corporation’s personnel. The revenue ruling holds that since the corporation owns the aircraft, has exclusive control over aircraft personnel, pays the operating expenses of the aircraft, and maintains liability and risk insurance all while the airline company operates the aircraft as an agent for the corporation, the airline company is not, with respect to this service, furnishing a transportation service for hire. Accordingly, the tax on the transportation of persons does not apply to amounts paid by the corporation to the airline company.

Rev. Rul. 74-123, 1974-1 C.B. 318, discusses a situation where an aviation company operates government-owned aircraft for a federal agency in providing transportation of agency personnel. The revenue ruling holds that when the company uses its own aircraft under the circumstance presented, amounts paid for the service rendered are clearly subject to the tax on transportation of persons by air under § 4261. Furthermore, the transportation service provided by the company when it operates government-owned aircraft is essentially the same service provided by the company when it uses its own aircraft. Under the circumstances of the case, the mere fact that the company uses government-owned aircraft rather than its own in carrying out the

contract is not sufficient to change the nature of the service as taxable transportation, for purposes of the tax imposed under § 4261.

The revenue ruling also holds that in computing the transportation tax due on the part of the service that involves the use of government-owned aircraft, the amount paid for the service includes not only the amount of money actually paid, but also the value of any contribution made by the agency toward providing the service, such as the value of the use of government-owned aircraft, insurance expense, etc. In lieu of computing the tax on the foregoing basis, the tax may be computed on the amount of money the company would charge the agency for the particular service if a comparable company-owned, rather than government-owned, aircraft were used.

Rationale

As a general matter, amounts paid to a person who leases an aircraft to others for air transportation but retains possession, command, and control of the aircraft are taxable under § 4261. Rev. Rul. 60-311. Also, the person who controls the pilot of an aircraft, such as the lessor under a "wet lease" arrangement, has possession, command, and control of the aircraft. Rev. Rul. 68-256.

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 § 4261. 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; in both situations, the company was providing taxable air transportation.

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 airline 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 aviation company was acting as a principal in providing air transportation to the federal agency. The aviation 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.

In this case, the Aircraft Owners purchase undivided interests in an aircraft from an entity related to Taxpayer. Under the purchase agreement, a precondition for purchase of the aircraft is that the owners enter into 1) a joint owner's agreement, 2) a management agreement with Taxpayer, and 3) a master interchange agreement with all aircraft owners in the X program.

Under the management agreement, Taxpayer agrees to inspect, maintain, service, repair, overhaul, and test the aircraft at its own expense. Taxpayer agrees to make all necessary take-off, flight and landing arrangements; and to provide trained and qualified pilots, pilot training, pilot medical exams and uniforms, hangar space, general storage space, tie-down, in-flight catering, flight planning and weather services, and communications, all at its own expense. In addition, Taxpayer agrees to obtain at its own expense both all-risk aircraft hull insurance and liability insurance. Finally, Taxpayer agrees to maintain all records, logs, and other materials required by the FAA, all of which is available for owners' inspection upon reasonable notice to Taxpayer during business hours. While the agreement permits the Aircraft Owners to appoint representatives to make decisions with respect to the aircraft, most major decisions are made by Taxpayer through the agreement.

If an aircraft in which an owner has an interest is not available for the owner's use at a particular time, then under the management agreement Taxpayer may provide another aircraft from the X program. If no aircraft is available from the X program, Taxpayer must provide the owner with the use of a suitable and comparable replacement aircraft from outside the program.

Given all of the circumstances, including the preconditioned mutual agreements and the respective responsibilities of the parties, we conclude that the Aircraft Owners, although title holders to the aircraft, have relinquished possession, command, and control of their respective aircraft to Taxpayer, who provides air transportation for hire.

The amounts paid for taxable transportation provided by Taxpayer include both the Monthly Management Fee and the Variable Rate Fee, as well as any Additional Fees paid to Taxpayer (together the "Fees"). Taxpayer argues that the Fees, in part, defrayed certain administrative costs and costs associated with aircraft ownership by the Aircraft Owners, not costs of transporting persons for compensation or hire. The Fees, however, were amounts paid by the Aircraft Owners to Taxpayer not as an agent for the owners, but as a principal that was providing air transportation for hire. Taxpayer was responsible for various services that were directly and indirectly related to maintaining and providing aircraft in the X program and bore the expenses of those services. The services provided by Taxpayer are related to the air transportation, and, therefore, amounts paid by the Aircraft Owners to Taxpayer for the services are taxable.

Pursuant to § 49.4261-2(c), though, charges for nontransportation services may be excluded in computing the tax payable if the charges are separable and in Taxpayer's records. Accordingly, any portion of the Fees paid to Taxpayer 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 nontransportation services, may be excluded in computing the transportation tax, provided those amounts are separable from the amounts attributable to taxable transportation and the Area Director is satisfied that Taxpayer's records show the exact amounts.

Additionally, as provided in Rev. Rul. 74-123, in computing the air transportation tax, the "amount paid" to the Taxpayer for taxable transportation includes not only the Fees actually paid by the Aircraft Owners, but also the value of the use of the aircraft provided by the owners.

Caveats

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent. Under § 6110(c), names, addresses, and identifying numbers have been deleted.