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### **CLIENT ALERT**

#### **NetJets Federal Excise Tax Litigation Opinion by Keith Swirsky**

On January 26, 2015, the United States District Court for the Southern District of Ohio issued an Opinion and Order (the "Opinion") in *NetJets Large Aircraft, Inc., et al., v. United States* (the "NetJets Litigation"). In the Opinion, the court ruled on several motions for summary judgment filed by the parties (each, a "Motion").

With respect to the NetJets aircraft fractional ownership program, the court granted the United States' Motion and determined that NetJets provides taxable transportation under Internal Revenue Code Section 4261, which imposes an excise tax on, among other things, amounts paid for transportation of persons by air ("FET"). However, the court also granted a Motion by NetJets' and held that IRS guidance issued in 1992 regarding the application of the FET to the NetJets program, which stated that FET is due only on the occupied hourly rate portion of the fees charged to NetJets customers, continues to bind the IRS until such time as the IRS provides further guidance expanding the scope of the FET liability to include either NetJets' management fees, or its fuel variable surcharges, or both. Accordingly, for the years under audit, the court held that that the IRS cannot retroactively assert that excise tax is due on the management fee and the fuel variable charge.

The court's ruling regarding the application of the FET to the NetJets management fees and fuel variable surcharges is certainly a victory for NetJets. However, other fractional aircraft ownership programs cannot rely on it as it is premised on the 1992 IRS guidance issued solely with respect to the NetJets program. Thus, the Opinion is of limited usefulness in that regard.

With respect to Executive Jet Management, an affiliate of NetJets that operates a traditional aircraft management business, the court's rulings were not favorable. The court noted that the IRS assessed FET only on fees paid by EJM customers who placed their aircraft in EJM's charter program. Accordingly, the court did not consider whether FET is due on fees paid by customers whose aircraft were operated only under Part 91 of the Federal Aviation Regulations. Therefore, it is not possible to reach any conclusion based on the Opinion as to whether or not the IRS will assert, in other cases, FET liability on Part 91-only customers.

In addition, the court confirmed that the IRS' standard of "possession, command and control" is an appropriate test to determine whether or not a management company is providing a transportation service to the aircraft owner. The court mentioned several relevant factors, including who performs services that allow the aircraft to be operational, who provides crew to operate the aircraft, and whether the services provided by the management company are similar or different than the services provided to a customer by a charter company. However the aforementioned factors are not exclusive, and the court determined that a multifactor analysis must be performed to determine which party has "possession, command and control" of the aircraft. The court confirmed that ownership of the aircraft is not dispositive of the issue of who has "possession, command and control" of the aircraft, but instead is one of the factors to be included in the multifactor analysis. While the court confirmed that the language used in the management agreement does not determine the outcome of the tax analysis, it is certainly clear that a poorly drafted contract would have negative consequences in a multifactor analysis approach.

In conclusion, although the court's rulings in the Opinion are favorable to NetJets, they do not resolve outstanding issues pertaining to traditional aircraft management structures and whether the FET applies to payments made in connection therewith.

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