

# Federal Excise Tax Update/ Significant Issues in Aircraft Purchase & Sale Documentation Including Importation Into the U.S

GKG Law, P.C. 2013-2014 Webinar Series

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## FET Issue

- FET is for Commercial Air Transportation
  - What is “commercial”?
  - What is “air transportation”?
  - When is a management company an “agent”?



## FET Issue

- “Air transportation” means providing both PILOT and AIRCRAFT
  - To provide the aircraft, the management company must first *have* the aircraft (i.e. have possession, command, and control of the aircraft)
  - Actions by management company as “agent” should be attributed to the owner as “principal”
    - If management company is “agent,” then management company cannot provide air transportation to owner





# FET Revenue Rulings

- Rev Rul 58-215: No FET
  - Management company was Owner’s “agent”
  - Owner had “exclusive control” of pilots
- Rev Rul 74-123: FET applied
  - Scheduled flights between definite points
  - Management company operated fleet
  - Management company bore economic burden of aircraft operating costs
  - “Public aircraft”



# Private Letter Rulings

- TAM 9347007: No FET
  - Owner had “substantial control” of aircraft
  - Owner had operational control under Part 91 management arrangement
- TAM 9404007: FET applied
  - Management company performed virtually all decision-making regarding the aircraft
  - Management company had operational control apparently under Part 135



## *Petit Jean Air Service, Inc. v. U.S.*

- S corporation constructively leased its aircraft to its sole shareholder
- Corporation employed the pilot, but did not provide air transportation to shareholder
- Court considered whether—  
“the transaction was characterized by the objective attributes of a lease, notably the right to possess, use, and control the aircraft”





## CCA 2012-10026 (March 9, 2012)

- CCA concludes that a management company is subject to FET, unless it falls within Rev. Rul. 58-215 facts—
  - (a) Mgmt co is the “agent” of owner, AND
  - (b) Owner has “exclusive control” of the pilots
- CCA notes that control of pilots is a “factor” in determining possession, command, and control



## Problems with CCA

- CCA states that all non-agent management companies are subject to FET, unless they are “agents” of owner
  - This conclusion ignores the issue of possession, command, and control
  - CCA assumes management company performs virtually all decision-making, if it is not the “agent” of owner





## Problems with CCA

- CCA states that it is irrelevant to possession, command, and control:
  - Which party owns the aircraft
  - Which party determines when and where the aircraft flies
  - Which party has operational control of the aircraft
- ➔ Rev. Rul. 58-215 makes it clear that ownership is relevant to PCC



## Recent Audit Experience

- IRS aggressively pursuing FET audits of aircraft management companies in recent years
- Aggressive pace accelerates following issuance of CCA 2012-10026 (March 9, 2012)
- IRS suspends further FET audit assessments in May, 2013



## Recent Audit Experience

- Audits in progress continue, but no final assessments being issued
- Proposed assessments being forwarded to Washington, DC
- Appeals are moving forward





## Recent Audit Experience

- Charges subject to FET
  - Management Fees
    - What if management fee includes pilot salaries, benefits, training, etc.
  - Maintenance administration fee/maintenance costs
  - Dispatcher fees



## Recent Audit Experience

- Charges subject to FET cont.
  - Pilot services fee/pilot salaries
  - Fuel “mark-up” charges over cost
  - Operating fund deposits
  - All other reimbursements



# Recent Audit Experience

- Offsets/Credit
  - Fuel tax credit – 17.5 cents/gallon
  - International travel
  - Charter use
  - Double taxation of operating fund deposits





## Recommendations for Aircraft Management Companies and Owners

- ➔ Revise Aircraft Management Contracts to support position that Owner retains possession, command and control and that management company is merely the Owner's agent.



# Recommendations for Aircraft Management Companies and Owners

→ Primary considerations in revising Aircraft Management Contracts:

- Principal/Agency
- Pilots
- Scheduling
- Maintenance
- Insurance
- Leasehold possessory rights



# Recommendations for Aircraft Management Companies and Owners

## → Principal/Agency

- Eliminate disclaimer of principal/agency relationship
- Add text specifically stating that Manager shall act as the Owner's agent in the performance of services





# Recommendations for Aircraft Management Companies and Owners

- Pilots: who employs/controls the pilots
  - Aircraft Owner should employ pilots; or
  - Pilots employed by Manager act as agents of Owner during Owner flights, and
    - Owner participates in interviewing, hiring and supervision
    - Owner can request re-assignment of pilots/refuse to use any pilot
    - Owner has the right to employ directly at any time



# Recommendations for Aircraft Management Companies and Owners

## → Scheduling

- Owner always retains first priority right to use of the aircraft
- Owner must affirmatively approve each charter request by Manager
- No Owner response to a request = denied
- Owner's right to rescind a prior approval at any time



# Recommendations for Aircraft Management Companies and Owners

## → Maintenance

- Manager provides maintenance as an agent of Owner
- Owner retains right to obtain maintenance services elsewhere, subject to right of Manager to terminate charter operations if necessary due to regulatory issues





# Recommendations for Aircraft Management Companies and Owners

## → Insurance

- Owner obtains insurance ideally
- Manager obtains insurance as an agent of Owner
- Owner retains right to obtain insurance at any time



# Recommendations for Aircraft Management Companies and Owners

- Leasehold possessory rights
  - Utilize leasing text to grant Manager rights to possess, use and operate the aircraft for charter operations
  - Specify that Manager's possessory rights exist only during such times that a charter has been approved, and that at all other times, Manager shall have no rights to possess, use or operate the aircraft



# NBAA/NATA Meetings with IRS

## → Background

- *Executive Jet Aviation* case (1997) held that NetJets fractional program was transportation service subject to FET, but no FET was assessed on management fee
- Fractional providers did not collect FET on management fee
- IRS audited fractional providers for FET on management fees





# NBAA/NATA Meetings with IRS

## → Background (continued)

- IRS occasionally audited Part 91 management companies for FET on managed aircraft
- In 2008, IRS issued an Audit Technique Guide suggesting that performing management services triggers FET
  - The ATG seemed inconsistent with IRS Rulings
- IRS increased FET audits



# NBAA/NATA Meetings with IRS

## → Meetings with IRS

- During 2008-2011, NBAA met with IRS representatives several times regarding possible Industry Directive
- Summer 2011, NBAA met with representatives of IRS Exam re FET on management companies
- IRS Exam refused further meetings and requested guidance from Chief Counsel



# NBAA/NATA Meetings with IRS

## → Meetings with IRS (continued)

- Chief Counsel issued CCA 201210026 (March 9, 2012)
- IRS increased FET audits of management companies
- Spring and Summer 2012, NBAA met with IRS Chief Counsel and Branch Chief of Excise Tax Branch





# NBAA/NATA Meetings with IRS

## → Meetings with IRS (continued)

- June 2012, NBAA/NATA Industry Response Tax Memorandum to CCA sent to IRS
- December 2012, NBAA/NATA provided a draft CCA and met with Branch Chief
- February 2013, NBAA/NATA memorandum sent to Branch Chief explaining that Rev. Rul. 74-123 does not provide clear guidance for Part 91 management companies



# NBAA/NATA Meetings with IRS

## → Meetings with IRS (continued)

- March 2013, NBAA/NATA met with Branch Chief; IRS attorneys agreed that Rev. Rul. 74-123 does not provide clear guidance
- April 2013, NBAA requested priority guidance
- May 2013, NBAA/NATA met with Commissioner of SBSE and attorney from Chief Counsel; SBSE suspended assessments of FET



# NBAA/NATA Meetings with IRS

## → Meetings with IRS (continued)

- May 2013, NBAA met with Treasury Tax Legislative Counsel re FET guidance and provided draft of Treas. Reg. § 49.4262(a)2
- August 2013, IRS priority guidance plan
- September 2013, NBAA/NATA met with Legislative Counsel and attorney from Chief Counsel's Office and provided another memorandum





# NBAA/NATA Meetings with IRS

## → Next Steps:

- Additional NBAA/NATA meetings planned with IRS and Treasury
- NBAA FET Working Group is working to provide legal analysis to address issues of concern to Chief Counsel attorneys drafting regulations



## Draft Regulations and CCA

- Owner has PCC, unless actually or constructively leases aircraft to management company
- Constructive leases are generally found based on concepts like which party has—
  - the right to control the aircraft
  - the right to operate the aircraft for his own benefit and enjoyment
  - the right to exclude others from the aircraft



## Effect on IRS FET Audits

- “Clear and precise” guidance is required to hold “deputy tax collector” liable for failure to collect FET (*Central Illinois*)
- Branch Chief’s office agrees Rev. Rul. 74-123 is not “clear and precise” authority regarding Part 91 management company’s duty to collect FET
- Is SBSE’s suspension on assessments helpful?





# Significant Issues in Aircraft Purchase & Sale Documentation Including Importation Into the U.S.



# Import/Export Transactions: Managing Expectations

- Types of representations
  - Clear title
  - Aircraft condition/airworthiness
  - Aircraft specification
- Survival of representations



# Import/Export Transactions: Managing Expectations

- ➔ Timing of release of funds
  - Lenders' requirements
  - Escrow Agreements
- ➔ Delivery location
- ➔ Use of Trusts/U.S. Brokers





# Import/Export Transactions: Managing Expectations

- Deposit amount
- Exchange rate fluctuations
  - In what currency is the purchase price payable?
  - Increased risk of default may justify increased deposit/remedies



# Import/Export Transactions: Managing Expectations

Carrying Seller as an additional insured

→ Choice of law/forum

→ Article 2(e) of the United Nations  
Convention on Contracts for the  
International Sale of Goods



# Import/Export Transactions: Exporter's Issues

## Deregistration request

- Make/model/serial number/N-number
- Reasons for deregistration (e.g., export)
- Destination country

→ No liens on file





# Import/Export Transactions: Exporter's Issues

- Notice of Deregistration/Non-Registration
- Export C-of-A / DAR Inspection



# Import/Export Transactions: Exporter's Issues (IDERA on File)

Secured Parties/Lenders acting pursuant to an Irrevocable Deregistration and Export Request Authorization (IDERA) must:

- certify “that all registered interests ranking higher in priority to that of the requestor have been discharged or that the holders of such interests have consented to the cancellation for export purposes”
- provide evidence of the discharge of interests or consent of higher ranking interest holders



# Import/Export Transactions: Importer's Issues

- ➔ Notice of Deregistration/Non-Registration
  - Should be in English to avoid a 1-3 day delay
  - Additional certification may be required if 90 days has elapsed
- ➔ Bill of Sale/Proof of Ownership
  - Original, ink signature (no fax/pdf/etc)
  - Establish full Chain of Title





# Import/Export Transactions: Importer's Issues

## → C-of-A

- DAR inspection
- 135 Conformity inspection
- Equipment requirements

## → DAR inspection letter



# Import/Export Transactions: Importer's Issues

- Title Opinion/Title Insurance
- Application for Registration (8050-1)
  - Pink copy is not an authorization for domestic ops
  - Fly-wire automatic; no need for DIO



# Closing Remarks

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