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Memorandum**

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subject: Transportation of Persons by Air - Taxability of Aircraft Management Fees

This Chief Counsel Advice responds to your request for assistance dated November 22, 2011. This advice may not be used or cited as precedent.

ISSUES

1. Is the control of an aircraft's pilots a factor for determining the person that has possession, command, and control of an aircraft?
2. Who has possession, command, and control of the aircraft in each of the three factual scenarios described below?
3. Are the monthly management fees paid to the aircraft management company in each of the three scenarios described below "amounts paid for taxable air transportation of persons," and thus taxable under § 4261 of the Internal Revenue Code (Code)?¹

CONCLUSIONS

1. Control of an aircraft's pilots is a factor for determining the person that has possession, command, and control of an aircraft.

¹ This memo does not address situations involving aircraft fractional ownership programs.

2. Management has possession, command, and control of the aircraft in all three of the scenarios described below.
3. The monthly management fees, as well as the separately reimbursed amounts, paid to Management in each of the three scenarios described below are "amounts paid for taxable air transportation" of persons, and thus are taxable under § 4261.

FACTS

Scenario 1

Owner owns an aircraft that it uses to transport executives and employees of Owner and related entities. Owner and the related entities constitute an affiliated group as defined in § 4282(c). The aircraft is titled and registered in Owner's name. Owner hires an aircraft management company (Management) to manage its aircraft operations. Owner pays Management a monthly management fee for its services, an hourly fee for each hour of flight time, and the separately reimbursed amounts described below. Management may also add a fuel surcharge to the hourly fee if the price of fuel exceeds a set amount.

Pursuant to the agreement between Owner and Management, Management is required to provide qualified pilots and crew. Although Management initially selects the pilots, Owner retains the ultimate right of refusal in pilot selection. Owner also retains the right to replace the pilots and crew members assigned to the aircraft at anytime with a different set of pilots and crew members selected by Management. Owner designates the destination for flights, but the pilots have the ultimate discretion regarding safe operation of the aircraft. The pilots and crew members are Management's employees and receive their pay, benefits, and income tax reporting documents from Management. Owner reimburses, separate from the monthly management fee, Management for the costs attributable to employing the pilots and crew members. Management is responsible for ensuring that the pilots receive all training required for flying Owner's aircraft. Owner reimburses, separate from the monthly management fee, Management for the training provided and arranged for by Management.

In addition to selecting and training the pilots and crew, Management performs all of the maintenance on the aircraft and is responsible for ensuring that all FAA maintenance and related recordkeeping requirements are satisfied. Management cleans the interior and exterior of the aircraft as part of its regular maintenance schedule. Management also provides aircraft scheduling, flight planning, and weather services.

Management is responsible for selecting and maintaining an insurance policy for the aircraft. The insurance policy names Owner as the insured party. Owner bears the

risk of loss for any claims resulting from the aircraft's operations in excess of amounts covered by insurance. Management does not indemnify Owner for any losses or claims resulting from the aircraft's operations.

Only Owner and its identified affiliated entities may use the aircraft. Management may not use the aircraft for charters with unrelated third parties. All flights are operated under the Federal Aviation Administration (FAA) Federal Aviation Regulations (FAR) part 91 (related to general aviation flight rules).

Scenario 2

Same fact pattern as *Scenario 1*, except that Owner allows additional, related entities that are not members of the affiliated group to use the aircraft for business-related travel. The same pilots fly all flights on the aircraft. Again, Management may not use the aircraft for charters with unrelated third parties. Flights are operated under FAR part 91.

Scenario 3

Same fact pattern as *Scenario 1*, except that Owner allows Management to operate the aircraft for charter service when Owner is not using the aircraft. Under this arrangement, Management uses the same pilots and crew for the third party chartered flights that serve on Owner's flights. Owner has priority use of the aircraft and can bump a third party charter if it provides notice at least 24 hours before the flight. If the aircraft is needed within the 24 hour window that a charter is booked, Management will provide another comparable aircraft for Owner to use.

In exchange for Management's use of the aircraft, Owner receives a portion of the charter revenue from the charters to unrelated third parties. Unrelated third party charters are flown under a FAR part 135 certificate (related to commuter and on-demand flight operations) held by Management. In addition, Management maintains insurance for the aircraft, which limits Owner's risk of loss to amounts in excess of the amounts covered by the insurance policy.

LAW AND ANALYSIS

Section 4261(a) of the Code imposes a tax on the amount paid for the taxable transportation of any person. "Taxable transportation" is defined in § 4262(a)(1) to generally include transportation by air that begins and ends in the United States. Section 4261(d) provides that the tax is paid by the person making the payment subject to tax and § 4291 provides that the tax is collected by the person receiving the payment.

Section 4282(a) generally exempts from the § 4261 tax amounts paid by one member of an affiliated group to another member for air transportation on an aircraft if, on any particular flight, the aircraft is not available for hire by persons who are not

members of the group.

The three questions that you asked relate to whether monthly management fees paid by Owner to Management are subject to the taxes imposed by § 4261. To determine whether these fees are taxable requires that we first determine whether Management provides taxable transportation to Owner. If we determine that Management provides taxable transportation to Owner, we must then determine whether the monthly management fee is an "amount paid" for that taxable transportation.

In Rev. Rul. 60-311, 1960-2 C.B. 341, aviation companies leased aircraft to lessees, and provided pilots, experienced mechanics, and maintenance services. The lessees determined the time and place for flights, but the aviation companies controlled load limits, decisions on whether to fly in given weather conditions, etc. Thus, the lessees had no control over the pilots beyond specifying qualifications and time and place for operations. Further, the aviation companies agreed to accept responsibility for all losses, damages, expenses, liability, and claims resulting from their performance of the contracts. The revenue ruling holds that because the aviation companies maintained possession, command, and control of the aircraft and performed all services in connection with their operation, the aviation companies were furnishing taxable transportation to the lessees, not merely leasing aircraft.

Determining whether a person has possession, command, and control of an aircraft requires an examination of all of the facts and circumstances of a particular case. However, the IRS's rulings in this area reveal that certain facts are emphasized when determining whether possession, command, and control were transferred from one person to another person.

In Rev. Rul. 57-545, 1957-2 C.B. 749, an airline company leased an aircraft to another company and then operated (including providing pilots, subject to the approval of the lessee company), serviced, maintained, and insured the aircraft in order to transport officials of the lessee company. At the lessee company's expense, the aircraft was painted and extensively modified in accordance with the specifications of the lessee company. The ruling holds that the airline company provides taxable transportation services to the lessee company under § 4261.

Rev. Rul. 58-215, 1958-1 C.B. 439, holds that where a corporation owns an aircraft and appoints an airline company as its agent to service, maintain, overhaul, and operate the aircraft for the purpose of transporting the corporation's personnel, the airline company is not furnishing transportation service to the corporation. In so holding, the revenue ruling emphasizes that the corporation owns the entire aircraft, has exclusive control over the aircraft's personnel (even though the personnel were initially selected by, and on the payroll of, the airline), pays the operating expenses of the aircraft, maintains liability and risk insurance, and the airline operates the aircraft as an agent for the corporation. In contrast to the facts in Rev. Rul. 57-545, the corporation in

Rev. Rul. 58-215 has the authority to dismiss the aircraft's personnel who are permanently based with, and exclusively assigned to, the corporation's aircraft. In addition, and unlike the facts of Rev. Rul. 57-545, the airline company in Rev. Rul. 58-215 is the agent of the corporation.

Rev. Rul. 68-256, 1968-1 C.B. 489, concludes that when a person leases an aircraft and operates the aircraft with its own crew, the lease payment is a payment for use of an aircraft that will be under the control of the person during the term of the lease. Consequently, the revenue ruling holds that the payment is a rental payment rather than a payment for taxable transportation. On the other hand, the revenue ruling concludes that when a person leases an aircraft that includes the use of a crew supplied by the lessor, control of the aircraft remains with the lessor because the lessor's crew is responsible for operations of the plane during the term of the lease. Accordingly, the revenue ruling holds the lease is in the nature of a charter arrangement of a type described in § 49.4261-7(h) of the Facility and Services Excise Tax Regulations (regulations).

Rev. Rul. 70-325, 1970-1 C.B. 231, holds that where an individual leased an aircraft to a corporation in which he is the sole stockholder, the corporation is furnishing transportation services to the individual and other persons, and payments made by them to the corporation are amounts paid for taxable transportation. The revenue ruling reasons that under the terms of the lease whereby the corporation registers, operates, maintains, and services the aircraft and furnishes the pilot, the individual transferred all the elements of possession, command, and control of the plane to the corporation.

Rev. Rul. 74-123, 1974-1 C.B. 318, holds that an aviation company that provides domestic air transportation services to a government agency using government-owned aircraft provides taxable transportation to the government agency, and that amounts paid (both in cash and in-kind) to the aviation company is taxable under § 4261. The revenue ruling reasons that the transportation services provided by the aviation company when it operates government-owned aircraft is essentially the same services it provides when it uses its own aircraft to provide domestic air transportation. The revenue ruling explains that the mere fact that the aviation company uses government-owned aircraft rather than its own aircraft in carrying out the contract is not sufficient to change the nature of the service as taxable transportation.

Rev. Rul. 76-394, 1976-2 C.B. 355, holds that amounts paid to a company (X company) by its wholly owned subsidiary and other companies in which its stockholders have a substantial interest, or a controlling interest and are officers and directors, under an agreement whereby the companies share in the operating expenses of an aircraft based on their percentage of use, are amounts paid for the taxable transportation. The revenue ruling reasons that because the title and registration of the aircraft is in the name of X company as owner of the aircraft, and the pilot and crew are on X's payroll, X company is deemed to have the essential elements of possession, command and control of the plane at all times, irrespective of the fact that the other participating

companies may direct the pilot as to destination and other details concerning actual flights when they use the aircraft.

Rev. Rul. 78-75, 1978-1 C.B. 340, holds that the status of an aircraft operator under FAA rules, including FAR, is not determinative in applying the air transportation taxes imposed by § 4261.

Issue 1

You first asked whether the control of an aircraft's pilots is a factor for determining who has possession, command, and control of an aircraft. Based on the revenue rulings discussed above, we conclude that control of an aircraft's pilots is a factor for determining who has possession, command, and control of an aircraft. Also, when determining who has control over the pilots, the ability to direct the pilots as to destination and time of flights should not be considered determinative.

Issue 2

You next asked which party has possession, command, and control of the aircraft in each of the three factual scenarios discussed above.

Scenario 1

In *Scenario 1*, although Owner is the insured party under the aircraft's insurance policy and it bears all risk of loss that result from aircraft operations, Management exercises virtually all decision making with regard to the operation and maintenance of the aircraft. The fact pattern presented in this scenario is distinguishable from the fact pattern presented in Rev. Rul. 58-215. Unlike the corporation in Rev. Rul. 58-215, Owner does not have exclusive control over the aircraft's personnel and Management does not operate the aircraft as an agent for Owner. The operational authority that Owner exercises over the aircraft is limited to selecting flight destinations, which are then scheduled by Management.

In determining whether an aviation company provides taxable transportation within the scope of § 4261, it is not relevant that 1) the persons being transported have the power to schedule and direct flights (Rev. Rul. 60-311); 2) Management does not own the aircraft through which it provides its services (Rev. Rul. 74-123); or 3) the FAR under which the aircraft is operated is part 91, part 135, or some other FAR (Rev. Rul. 78-75). Under these facts, Management provides all of the essential elements necessary for the transportation of persons by air. Therefore, we conclude that Owner relinquished possession, command, and control of the aircraft to Management in *Scenario 1*. Accordingly, we further conclude that Management provides taxable transportation to Owner.

Scenario 2

Scenario 2 presents the same facts as *Scenario 1*, except that additional related entities that are not members of Owner's affiliated group are permitted to use the aircraft. None of the facts relating to possession, command, and control of the aircraft changed from *Scenario 1* to *Scenario 2*. Thus, we conclude that Management has possession, command, and control of the aircraft, and that Management provides taxable transportation to Owner under the facts of *Scenario 2*.

Scenario 3

Scenario 3 presents same fact pattern as *Scenario 1*, except that Owner allows Management to operate the aircraft for charter service when Owner is not using the aircraft. None of the facts relating to possession, command, and control of the aircraft changed from *Scenario 1* to *Scenario 3*. Thus, we conclude that Management has possession, command, and control of the aircraft, and that Management provides taxable transportation to Owner under the facts of *Scenario 3*.

Issue 3

Finally, you asked whether the monthly management fees paid to Management in each of the three scenarios described above are amounts paid for taxable air transportation of persons and thus taxable under § 4261.

The concept of an "amount paid" for taxable transportation is addressed in guidance published by the IRS. Rev. Rul. 2006-52, 2006-2 C.B. 761, for example, states that an airline's costs associated with selling tickets are generally necessary to the air transportation the airline provides. Therefore, all amounts paid to an air transportation services provider that is necessary to receive air transportation services are generally part of the tax base. The regulations and other IRS published guidance, however, specifically exclude (or include) amounts paid for certain types of services.

For example, the non-taxable items described in § 49.4261-8(f)(4) of the regulations generally relate to meals, entertainment and hotel accommodations. Therefore, an amount paid for any service that falls into one of these categories is not included in the § 4261 tax base, provided it meets the recordkeeping requirements of § 49.4261-2(c).

For services that are not addressed by the regulations, IRS published guidance generally limits the tax base to amounts paid for mandatory charges; in essence, amounts that must be paid to get on the aircraft for a certain type or level of service. Rev. Rul. 73-508, 1973-2 C.B. 366, for example, holds that a security charge is part of the amount paid for taxable transportation because it is required to be paid as a condition to receiving air transportation.

Rev. Rul. 80-31, 1980-1 C.B. 251, holds that a service charge is not an amount paid for taxable transportation if the service is optional, not reasonably necessary to the

air transportation itself, and bears a reasonable relation to the cost of providing the service.

Therefore, all amounts paid as a condition to receiving air transportation are subject to tax unless the service is also optional and not reasonably necessary to the air transportation itself.

Owner is required to pay Management the monthly management fee in order to use the aircraft for air transportation services. The monthly management fees stand in contrast to the nontransportation services described in IRS published guidance because the fees are paid to cover expenses related to air transportation services (such as maintenance, cleaning, recordkeeping, scheduling, flight planning, and weather services) rather than mere incidental costs such as meals or entertainment. Costs covered by the monthly management fees are reasonably necessary to the air transportation itself because without maintenance, and administrative services like weather information and flight planning, Management could not provide air transportation services to Owner.

Further, it is not relevant to this analysis that the monthly management fees may cover indirect (or overhead) costs of Management rather than direct costs of flight operations. For example, imbedded in the purchase price of a passenger ticket on a commercial air carrier or chartered flight are essentially similar indirect costs that make up the monthly management fees. Amounts paid for air transportation do not escape taxation merely because they are split from direct costs of the transportation and paid separately by the person purchasing the services.

Payment of monthly management fees, as well as the separately reimbursed amounts described in the scenarios above, is a precondition to receiving air transportation services from Management and thus, are amounts paid for taxable transportation. Accordingly, we conclude that the monthly management fees, as well as the separately reimbursed amounts, paid by Owner to Management are amounts paid for taxable transportation and are therefore subject to the taxes imposed by § 4261.

Please call (202) 622-3130 if you have any further questions.