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CLIENT ALERT

IRS SUSPENDS ASSESSMENT OF FET ON OWNER FLIGHTS ON MANAGED AIRCRAFT

by
Keith Swirsky

The IRS is suspending assessments of Federal Transportation Excise Taxes (FET) on owner flights on managed aircraft, while the IRS and Treasury work on developing clear guidance on this issue. This is a significant development, and as many of you are aware, the IRS has been aggressively auditing aircraft management companies and assessing FET on amounts paid by the aircraft owner to the management company for the owner's flights, including aircraft management fees, pilot salaries, maintenance reimbursement costs, and a variety of other charges that are normally part of an aircraft operating budget.

GKG Law has handled many FET audits, and despite the May 16th IRS announcement, these audits are continuing. If you receive notice of an audit, please call us for guidance; please do not assume that the auditor will limit the scope of the inquiry; instead, the auditor is there to make an assessment, and representation on the front-end is critical.

Below is an article written by John Hoover, which recently appeared on the NBAA website, providing about as much detail as is available at the current time. For more resource information, please go to the link on NBAA's website on this issue: http://www.nbaa.org/admin/taxes/federal/fet/management-fees/. We will continue to provide further information as it develops.

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IRS Suspends Federal Transportation Excise Tax Assessments for Owner Flights on Managed Aircraft

May 20, 2013

By John B. Hoover

On May 16, 2013, the IRS informally announced that it will suspend the assessment of Federal Transportation Excise Tax ("FET") on owner flights on aircraft managed by aircraft management companies. The announcement was made in response to a meeting the previous week with representatives of the National Business Aviation Association (NBAA) and the National Air Transportation Association ("NATA"). This article discusses (a) the implications of this suspension on assessments, (b) the meetings and efforts by NBAA leading up to this suspension on assessments, and (c) expected future guidance from the IRS on this issue.

In recent years, but particularly after the issuance of Chief Counsel Advice 2012-10026 (March 9, 2012) (the "CCA"), the IRS has been aggressively auditing aircraft management companies and asserting that FET applies to flights by aircraft owners on managed aircraft. The IRS argues that the management company has taken possession, command, and control of the aircraft and is providing air transportation service to the aircraft owner. However, the IRS has not issued clear guidance that can be cited as legal precedent to support this theory. (CCAs cannot be cited as legal precedent.)

Implications of the Suspension on Assessments

The suspension on assessments of FET was announced by the Small Business / Self Employment (SBSE) division of the IRS, which includes the FET auditors. The intent is to suspend the collection of these taxes until after the issuance of clear authoritative guidance, such as regulations. At the SBSE meeting, we requested that the IRS terminate the FET audits of owner flights, but SBSE decided to merely suspend the assessments instead.

We understand that this decision was communicated informally to FET audit managers, likely by conference call. If the guidance project takes a long time, then the lack of a written document announcing the suspension on assessments may result in misunderstandings with IRS auditors regarding the scope of the suspension.

Overview of FET Audit Process

As a procedural matter, an FET audit includes an examination of the taxpayer by an auditor and the issuance of an Examination Report in which the auditor proposes adjustments to the taxpayer's FET liability. If the taxpayer signs the audit report indicating agreement with the proposed adjustments, the FET is then assessed. If the taxpayer does not agree, but instead appeals the proposed adjustment to the IRS Appeals Office, then the taxpayer and the Appeals Office may reach an agreement resulting in an assessment of taxes. If they cannot agree at

Appeals, then the IRS would presumably assess the taxes and require payment, and the taxpayer could seek a refund in federal court.

Effect of the Suspension of Assessments on Existing Audits

Notwithstanding the suspension of assessments, FET examinations currently in progress may continue, and the IRS Agents may provide preliminary Examination Reports proposing FET taxes to be assessed. However, it is not expected that final Examination Reports (a/k/a 30-Day Letters) would be issued, because that would result in the cases going to Appeals.

Effect of the Suspension of Assessments on New Audits

A suspension of assessments does not preclude the initiation of new audits. We have been informally advised that the IRS does not intend to initiate new management company audits on this issue. However, the suspension would not preclude the initiation of FET audits for other issues (e.g., audits of FET collected on third-party charters and fuel tax audits). Accordingly, there is no guarantee that an auditor opening an examination of FET on charter flights will refrain from examining the owner flights as well. However, pursuant to the suspension on assessments, the results of any such examination of owner flights should not be included in a final Examination Report, as long as the taxpayer agrees to extend the statute of limitations.

Statute of Limitations

We further understand that the IRS does not intend to let the statute of limitations expire on current audits. Accordingly, management companies under audit should anticipate that the IRS will request that they sign a written consent to keep the statute of limitations open for a year or more to allow time for the IRS to issue guidance (such as regulations) on the issue. Management companies confronted by such a request should consider whether they would prefer to (a) not sign the consent to extend the statute of limitations and effectively force the issue to be considered at Appeals based on existing guidance, or (b) sign the statute extension in the hope that future guidance on the issue will be favorable.

Interest on Tax Liability

In deciding whether to agree to a statute extension that would allow a case to be suspended, a management company should consider the effect of interest that continues to accrue on any FET that is ultimately due. We are not aware of any special rule that would abate interest during the suspension period.

Cases in Appeals

Cases currently in IRS Appeals are not directly affected by the suspension, since the IRS Appeals Office is not under the jurisdiction of the SBSE division. It is possible that cases currently in Appeals may be settled in Appeals. However, if the taxpayer and the Appeals Officer are aware of the suspension, they may choose to suspend the Appeal pending the issuance of future guidance. We understand that SBSE may inform the Appeals Office of the suspension.

Clear and Precise Guidance Standard

Copies of the documents referenced below analyzing this issue are available on the NBAA web site. In particular, the industry response provided to the Chief Counsel's office explains that the U.S. Supreme Court in *Central Illinois Public Service Co. v. United States*, 435 U.S. 21 (1978),

held, with respect to *payroll tax withholdings*, that a company that is required to collect a tax (a "deputy tax collector") can only be held liable for uncollected tax if published legal authority provided clear and precise guidance regarding the deputy tax collector's obligation to collect the tax. Published court cases do not discuss whether this case applies in the context of FET.

However, since management companies appear to be deputy tax collectors required (according to the IRS auditors) to collect FET on amounts paid by the aircraft owners, it would appear to follow that management companies can only be held liable for uncollected FET if published legal guidance met this clear and precise standard.

As noted below, the sole reason for opening a guidance project on the issue is that the existing published legal authority does not provide clear guidance. Accordingly, it would seem that management companies have a fairly straightforward argument that (a) they can only be liable for failure to collect FET if the published legal guidance regarding their collection responsibility is clear and precise, and (b) the suspension of assessments and opening of a guidance project effectively concedes that existing guidance regarding owner flights does not meet this standard. Based on this and other arguments, management companies with cases in Appeals may prefer to continue to work with Appeals to resolve their cases.

Management companies that are currently under audit and are considering the effect of the suspension on their case should consider that the clear and precise guidance standard requires that such guidance exist at the time that the deputy tax collector was required to collect the tax. Therefore, if the clear and precise standard applies, regulations issued in the future cannot retroactively provide clear and precise guidance to prior periods when the tax was not collected.

Expected Future Guidance

In April 2013, NBAA submitted a request to the IRS to include this issue on the IRS priority guidance plan. Since the request is supported by the Chief Counsel's office attorneys and by SBSE, it seems highly likely that it will be included in the priority guidance plan. We are advised that the IRS will decide within the next week whether to add the project to the guidance plan and what form the guidance will take. From our meetings, it seems likely that the IRS will open a regulations project, rather than a less precedential form of guidance such as a revenue ruling or another chief counsel advice.

NBAA plans to continue to meet with IRS and Treasury representatives as guidance is developed on this issue. On May 9, 2013, NBAA representatives met with Treasury Tax Legislative Counsel and provided draft regulations along with other background materials on the issue.

Background Meetings Leading Up to the Suspension on Assessments

The suspension on assessments and the IRS' tentative commitment to initiate a guidance project on this issue is the result of a series of meetings between NBAA representatives and the IRS over the past five years.

Review a Brief Summary of the Effort.

John B. Hoover is an attorney with the law firm of Dow Lohnes PLLC. He has participated in the meetings discussed herein with the IRS on behalf of the NBAA, and he was one of the principal drafters of the documents provided to the IRS that are referenced herein.