DESCRIPTION OF H.R. 3608, A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1986 TO EXEMPT AMOUNTS PAID FOR AIRCRAFT MANAGEMENT SERVICES FROM THE EXCISE TAXES IMPOSED ON TRANSPORTATION BY AIR

Scheduled for Markup
by the
HOUSE COMMITTEE ON WAYS AND MEANS
on July 13, 2016

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

July 12, 2016
JCX-65-16

CONTENTS

INTRODUCTION

The House Committee on Ways and Means has scheduled a committee markup of H.R. 3608, a bill to amend the Internal Revenue Code of 1986 to exempt amounts paid for aircraft management services from the excise taxes imposed on transportation by air, on July 13, 2016. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the bill.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of H.R. 3608, a Bill to Amend the Internal Revenue Code of 1986 to Exempt Amounts Paid for Aircraft Management Services from the Excise Taxes Imposed on Transportation by Air*, (JCX-65-16), July 12, 2016. This document can also be found on the Joint Committee on Taxation website at www.jct.gov. All section references herein are to the Internal Revenue Code of 1986, as amended, unless otherwise stated.

A. Exemption From Excise Tax of Certain Amounts Paid for Aircraft Management Services

Present Law

Tax on domestic air transportation

A Federal excise tax is imposed on the amount paid for taxable transportation of any person by air[2] and a Federal excise tax is imposed on the amount paid for taxable transportation of any property by air.[3] In general, the tax imposed on domestic flights for the transportation of persons consists of two parts: a 7.5 percent tax on the amount paid plus a tax of $3 for each flight segment. The tax imposed on the transportation of property is 6.25 percent of the amount paid.

In determining whether a flight constitutes taxable transportation and whether the amounts paid for such transportation are subject to tax, the Internal Revenue Service ("IRS") has generally looked at the nature of the payments being made, and who has "possession, command, and control" of the aircraft based on the relevant facts and circumstances.[4]

Applicability of Federal excise tax to aircraft management services

Generally, an aircraft management services company ("management company") has as its business purpose the management of aircraft owned by other persons ("aircraft owners"). In this function, management companies provide aircraft owners with administrative and support services (such as scheduling, flight planning, and weather forecasting), aircraft maintenance services, the provision of pilots and crew, and compliance with regulatory standards. Although the particular arrangements between management companies and aircraft owners may vary, aircraft owners generally pay management companies a monthly fee to cover the fixed expenses of maintaining the aircraft (such as insurance, maintenance, and recordkeeping) and a variable fee to cover the cost of using the aircraft (such as the provision of pilots, crew, and fuel).

In addition to general management, aircraft owners frequently contract with management companies to place the owner's aircraft into a fleet of aircraft to be leased to third parties when not being used by the owner.

The applicability of Federal excise tax to aircraft management services has been the subject of litigation and has also been addressed in an IRS Chief Counsel Advice memorandum.[5]

---

[2] Sec. 4261.

[3] Sec. 4271.

[4] See, *e.g.*, Rev. Rul. 60-311, 1960-2 C.B. 341, which held that, since the company in question retains the elements of possession, command, and control of the aircraft and performs all services in connection with the operation of the aircraft, the company is, in fact, furnishing taxable transportation to the lessee; and the tax on the transportation of persons applies to the portion of the total payment which is allocable to the transportation of persons, provided such allocation is made on a fair and reasonable basis. If no allocation is made, the tax applies to the total payment for the lease of the aircraft.

[5] CCA 2012-10026 (March, 2012).

In the Chief Counsel Advice, the IRS determined under certain factual scenarios that aircraft management fees are generally considered amounts paid for taxable transportation of a person because possession, command, and control of the aircraft have been ceded by the aircraft owner to the management company under the terms of a management agreement. The IRS stated that control of the pilots is a factor in determining who has possession, command and control of the aircraft. In the scenarios described in the Chief Counsel Advice, while the aircraft is titled in the name of the owner, the pilots and crew are management company employees and receive their pay, benefits, and income tax reporting documents from the management company. In addition to selecting and training the pilots and crew, the management company performs all of the maintenance on the aircraft and is responsible for ensuring that all Federal Aviation Administration maintenance and related recordkeeping requirements are satisfied. Due to these factors, the IRS determined that the management company had possession, command and control of the aircraft and, as a result, was furnishing taxable transportation to the owner.

Because the IRS determined that the management company provided all of the essential elements necessary for providing transportation by air and the owner relinquished possession, command, and control to the management company, the management company was determined to be providing taxable transportation to the owner and was therefore required to collect the appropriate Federal excise tax from the aircraft owner and remit it to the IRS.

In a 2015 opinion,[6] an Ohio district court held that the existing revenue rulings (in effect for the tax period April 1, 2005, through June 30, 2009, the period that was the subject of the litigation) regarding the possession, command and control test, failed to provide precise and not speculative notice of a collection obligation as it related to whole-aircraft management contracts.[7] As a result, the court ruled as a matter of law that because precise and not speculative notice was not received, the aircraft management company plaintiff did not have a collection obligation with respect to the Federal excise tax on payments received for whole-aircraft management services.

Description of Proposal

The proposal exempts certain payments related to the management and maintenance of aircraft from the Federal excise tax imposed on transportation of persons and property.

Exempt payments are those amounts paid by an aircraft owner for management services related to maintenance and support of the aircraft or flights on the owner's aircraft. Applicable services include support activities related to the aircraft itself, such as its storage, maintenance, and refueling, and those related to its operation, such as the hiring and training of pilots and crew, as well as administrative services such as scheduling, flight planning, weather forecasting, and establishing and complying with safety standards.

---

[6] *Netjets Large Aircraft Inc. v. United States*, 116 A.F.T.R. 2d. 2015-6776 (S.D. Ohio, 2015).

[7] The district court held that such notice is required to persons having a deputy tax collection obligation under the rationale of the Supreme Court's holding in *Central Illinois Public Service Company v. United States*, 435 U.S. 21 (1978).

Payments for flight services are exempt only to the extent that they are attributable to flights on an aircraft owner's own aircraft. Thus, if an aircraft owner makes a payment to a management company for the provision of a pilot and the pilot provides his services on the aircraft owner's aircraft, such payment is not subject to Federal excise tax. However, if the pilot provides his services to the aircraft owner on an aircraft other than the aircraft owner's (for instance, on an aircraft that is part of a fleet of aircraft available for third-party leasing), then such payment is subject to Federal excise tax.

The proposal provides a pro rata allocation rule in the event that a monthly payment made to a management company is allocated in part to exempt services and flights on the aircraft owner's aircraft, and in part to flights on aircraft other than the aircraft owner's. In such a circumstance, Federal excise tax must be collected on that portion of the payment attributable to flights on aircraft not owned by the aircraft owner.

Under the proposal, a lessee of an aircraft is considered an aircraft owner provided that the lease is not a "disqualified lease." A disqualified lease is any lease of an aircraft from a management company (or a related party) for a term of 31 days or less.

Effective Date

The proposal is effective for amounts paid after the date of enactment.

B. Estimated Revenue Effect of the Proposal

The proposal is estimated to reduce Federal fiscal year budget receipts by less than $500,000 for the period 2017-2026.[8]

[8] It has been represented that, beginning in 2013, the Internal Revenue Service suspended tax assessment activities related to payments made to management companies to allow for the development and issuance of further administrative guidance by the agency. Further guidance on this topic has not been issued. The current suspension has been taken into account in estimating the revenue effect of the proposal.