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memorandum

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from: Frank Boland
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subject: Section 4261 - Aircraft Fractional Ownership Management Fees

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

ISSUE

Whether monthly management fees paid by an aircraft fractional owner (Participant) to a management company that operates an aircraft fractional ownership program, as described in the facts below, are amounts paid for taxable transportation under § 4261(a) of the Internal Revenue Code (Code) [1].

CONCLUSION

Monthly management fees paid by a Participant to a management company that operates an aircraft fractional ownership program are amounts paid for taxable transportation under § 4261(a).

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[1] You did not ask us to address the taxability of occupied hourly fees under § 4261(a). However, it is well established that occupied hourly fees paid to an aircraft fractional ownership program management company are amounts paid for taxable transportation and, therefore, are taxable under § 4261(a). Exec. Jet Aviation, Inc. v. U.S., 125 F.3d 1463 (Fed. Cir. 1997).

FACTS

You provided us with the following description of a typical aircraft fractional ownership program.

Fractional Ownership Program Manager (Program Manager) manages an aircraft fractional ownership program (Program) for Participants. Through the Program, each Participant is guaranteed a set number of flight hours in a certain aircraft class (measured by the aircraft's passenger capacity and speed). The number of flight hours allocated to each Participant is based on the size of the participant's ownership interest and type of aircraft in which that interest is held.

To become a Participant, a person purchases an undivided interest in an aircraft from the Program Manager (or an entity related to Program Manager) and enters into the following interlocking agreements (collectively, Operative Agreements):

- Purchase Agreement;
- Management Agreement;
- Joint Ownership Agreement; and
- Master Interchange Agreement (also called an Interchange Agreement, Exchange Agreement, or Dry Lease).

Of these agreements, the terms of the management agreement are most relevant to the issue presented here.

Management Agreement

The management agreement outlines the flight services that each Participant is entitled to as a Program participant. The management agreement (in conjunction with the master interchange agreement) generally provides each Participant with the use of the same class of aircraft (but not the exact aircraft in which it owns an interest) (Program Aircraft) for a set number of hours per year. The number of hours allocated to a Participant is proportional to the Participant's ownership interest, with additional flight time available for additional fees. Participants are generally permitted to use their flight hours simultaneously, thereby using two or more Program Aircraft at the same time. The management agreement gives Program Manager the right to use Participants' aircraft for flight training, demonstration, and other specified purposes. The management agreement does not limit Program Manager's use of the aircraft to a set number of hours and provides that it is entitled to keep for itself any reimbursement that it receives for those uses.

Under the management agreement, Program Manager assumes full responsibility for maintenance and operation of the aircraft. For a monthly management fee, Program Manager provides at its own cost the following services:

- Arrange for the aircraft to be inspected, serviced, repaired, overhauled, and tested in order to maintain the aircraft's airworthiness certification from the Federal Aviation Administration ("FAA").
- Keep the interior and exterior of the aircraft in good cosmetic appearance.
- Maintain all records, logs, and other materials required by the FAA with respect to the aircraft.
- Provide professionally trained and qualified pilots.
- Maintain hangar space, tie-down as required, weather and flight planning, catering, fueling and administrative communications and aeronautical radio services.
- Make all necessary takeoff, flight, and landing arrangements.
- Obtain and maintain aircraft hull and liability insurance.

In addition to the monthly management fee, each Participant pays Program Manager an hourly fee for each flight hour (including taxiing) that the Participant actually uses the aircraft (occupied hourly fee). The occupied hourly fee is designed to compensate Program Manager for the direct, variable costs of operating the aircraft. These costs include, but are not limited to, fuel charges, standard catering, maintenance, airport landing fees, and average fleet repositioning expenses.

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.

You asked whether monthly management fees paid by Participants to Program Manager are subject to the taxes imposed by § 4261. To determine whether these fees are taxable requires that we must first determine whether Program Manager provides taxable transportation to Participants. If we determine that Program Manager provides taxable transportation to Participants, we must then determine whether the monthly management fee is an "amount paid" for that taxable transportation.

Taxable Transportation

The longstanding position of the Internal Revenue Service (IRS) is that a person provides taxable transportation if that person has possession, command, and control of the means of conveyance, rather than mere legal title to the means of conveyance. Rev. Rul. 60-311, 1960-2 C.B. 341. In Exec. Jet Aviation, the Federal Circuit agreed with the IRS, finding that the aircraft fractional ownership program management

company in that case provided taxable transportation to their program participants.[2] 125 F.3d 1463, at 1469. As a result, the court found that the occupied hourly fees (which were the only fees at issue in that case) paid by the participants in Executive Jet's program to Executive Jet were taxable under § 4261. The Program is substantially similar to the aircraft fractional ownership program at issue in Exec. Jet Aviation. Accordingly, and without further analysis because you did not ask us to analyze in detail whether Program Manager provides taxable transportation, we conclude that Program Manager provides taxable transportation to Participants through the Program.

Amount Paid

We must next determine whether the monthly management fees are amounts paid for taxable transportation. 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.

Section 49.4261-8 of the Facilities and Services Excise Taxes Regulations (regulations) provides examples of payments for services that are not subject to the § 4261(a) tax. Section 49.4261-8(f)(1) provides that the § 4261(a) tax does not apply to charges for transportation of baggage, including incidental charges such as excess value, storage, transfer, parcel checking, special delivery, etc.

Section 49.4261-8(f)(4) provides that the tax does not apply to charges for admissions, guides, meals, hotel accommodations, and other nontransportation services, for example, where such items are included in a lump sum payment for an all-expense tour. However, if a payment covers charges for both transportation and nontransportation services, § 49.4261-2(c) provides that the nontransportation charges must be separable and shown in the exact amounts thereof in the records pertaining to the transportation charge, or the tax is computed upon the full amount of the payment.

Although the regulations do not define nontransportation services, the examples in § 49.4261-8(f)(4) 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 tax base, provided it meets the recordkeeping requirements of § 49.4261-2(c).

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[2] The court analyzed the issue of whether Executive Jet provided taxable transportation through the § 4041 aviation fuel excise tax rules that were in effect during the tax quarters at issue in that case. At that time, aviation fuel taxes only applied to noncommercial aviation and the § 4261 taxes only applied to commercial aviation. The court found that Executive Jet was in the business of providing commercial aviation, and thus the amounts it received from program participants was for taxable transportation.

Section 49.4261-7, on the other hand, provides examples of payments for services that are subject to the § 4261(a) tax. Section 49.4261-7(c) provides that amounts paid as additional charges for changing the class of accommodations, destination, or route, extending the time limit of a ticket, as "extra fare," or for exclusive occupancy of a section, etc., are subject to tax. Thus, any service that meets this provision is included in the tax base.

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, provides further guidance on whether an amount is paid for taxable transportation. The ruling considers the application of § 4261 to a service charge added by an airline to the price of a ticket for the administrative costs involved in the use of that ticket by another person in another city. The ticket in question could have been purchased without the service charge in the other city. The ruling concludes that the service charge is not an amount paid for taxable transportation because 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.

Participants are required to pay Program Manager the monthly management fee in order to access Program 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 pilot salaries and training, insurance, and hangering fees) 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 licensed pilots, insurance, and administrative services like weather information and flight planning, Program Manager could not provide air transportation services to Participants.

Further, it is not relevant to this analysis that the monthly management fees cover indirect (or overhead) costs of Program Manager 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.

Also, it is not relevant to this analysis that a participant may pay the monthly management fee but not use any of its allocated number of flight hours. The tax is imposed on amounts paid for taxable transportation and is not dependant on whether travel actually occurs. Thus, for example, a person must pay the § 4261(a) tax when the person purchases a commercial airline ticket, regardless of whether the person actually takes the flight. Payment of monthly management fees is a precondition to receiving air transportation services from Program Manager and thus, is an amount paid for taxable transportation.

Accordingly, we conclude that monthly management fees paid by a Participant to a management company that operates an aircraft fractional ownership program are amounts paid for taxable transportation and are therefore subject to the taxes imposed by § 4261.

Please call if you have any further questions.