NATA National Air Transportation Association
The Voice of Aviation Business

NBAA

Sept. 29, 2020

Ms. Stephanie N. Bland
Branch Chief, Branch 7 (Passthroughs & Special Industries)
Office of the Associate Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

SUBMITTED VIA REGULATIONS.GOV

Re: IRS REG–112042–19
Comments on proposed amendments to Facilities and Services Excise Tax Regulations

Dear Ms. Bland:

On behalf of the National Air Transportation Association ("NATA") and National Business Aviation Association ("NBAA"), thank you for the opportunity to comment on the proposed amendments to the Facilities and Services Excise Tax Regulations (26 CFR Parts 40 and 49). Our comments are in response to the federal register notice issued on Jul. 31, 2020. "Excise Taxes; Transportation of Persons by Air; Transportation of Property by Air; Aircraft Management Services," 85 Fed. Reg. 46,032 (Jul. 31, 2020). We appreciate the longstanding dedication to this rulemaking project by staff at the Internal Revenue Service ("IRS") and Department of the Treasury, especially with the ongoing and unprecedented impacts of the COVID-19 pandemic.

With the impacts of the pandemic, and in place of a public hearing, we respectfully request a call with the IRS and Department of the Treasury officials involved in this rulemaking to discuss our comments in more detail.

Both of our associations represent significant elements of the general aviation community, which includes all operations other than the scheduled commercial airlines and military. Our industry supports 1.2 million jobs, $247 billion in annual economic impact, and contributes $128 billion to U.S. GDP.

With NATA being the leading national trade association representing the business interests of general aviation service companies, and NBAA representing more than 11,000 member companies that depend on general aviation aircraft to make their businesses more productive and successful, our members have a direct interest in this rulemaking.

The majority of our comments focus on Prop. Treas. Reg. § 49.4261-10, which addresses the application of the exemption from Federal Excise Tax ("FET") for amounts paid by an aircraft owner to an aircraft management services provider for certain aircraft management services. Section 13822 of Public Law 115–97, 131 Stat. 2054, 2182 (2017), referred to as the Tax Cuts and Jobs Act ("TCJA"), amended the code by adding a provision that no tax shall be imposed by sections 4261 or 4271 for amounts paid by an aircraft owner for management services related to, or flights on, the owner's aircraft.

On May 24, 2018, NATA and NBAA submitted a Priority Guidance Request regarding the implementation of Section 13822 of the TCJA. While elements of our guidance request are addressed in Prop. Treas. Reg. § 49.4261-10, we have additional substantive comments on specific areas of the proposed regulations. We believe modifications or clarification in the following areas are necessary to align with statutory intent and provide further details to assist with tax administration.

Attributes of a Lease – Prop. Treas. Reg. § 49.4261-10(b)(3)(i)

While many aircraft leases are in writing and contain provisions making it clear that the arrangement constitutes a lease, this is not the case for all aircraft leasing arrangements. In some instances, these arrangements may be oral or constructive. Courts have found that the basic attributes of a lease are "the right to possess, use, and control the aircraft." *See Petit Jean Air Service, Inc. v. United States*, 74-1 U.S.T.C. 16,135 (D. Ark. 1974). We suggest clarifying that aircraft leasing arrangements that meet these basic tenets will be respected as leases for the purposes of determining whether the lessee is a deemed aircraft owner. We propose adding the following language to the end of Prop. Treas. Reg. § 49.4261-10(b)(3)(i):

> "An arrangement (whether written, oral, or implied) that transfers the right to possess, use, and control an aircraft to an individual or entity qualifies as a lease for the purposes of determining whether that individual or entity meets the definition of *aircraft owner*."

Owner Trusts – Prop. Treas. Reg. § 49.4261-10(b)(3)

The Preamble (85 Fed. Reg. § 46,034) confirms that disregarded entities are respected entities for FET purposes. However, the Preamble (85 Fed. Reg. 46,033-34) also states that an entity related to an aircraft owner is not covered by the exception in § 4261(e)(5) merely by being related to the aircraft owner. Instead, to be covered by the exception in § 4261(e)(5), a party can be a deemed owner of the aircraft by leasing the aircraft under § 4261(e)(5)(C). These rules raise the concern in the case of a business aircraft placed in an "Owner Trust" of whether the Owner Trustee and its "Beneficial Owner" are covered by the exception in § 4261(e)(5).

An Owner Trust is an ownership structure used for the limited purpose of registering an aircraft in the U.S. under 49 U.S.C. §§ 40102(a), 44102(a), and 14 C.F.R. § 47. A party that uses its aircraft for business or personal purposes may utilize an Owner Trust to satisfy citizenship requirements applicable to U.S. aircraft registration with the Federal Aviation Administration ("FAA"). FAA registration rules generally require that each individual and entity in the chain of ownership of the aircraft or who control the aircraft owner be a "citizen of the United States" as defined in 49 U.S.C. § 40102(a)(15). For income tax purposes, Owner Trusts are grantor trusts and disregarded entities under § 671 et seq., including § 676.

Title to thousands of business aircraft are held in Owner Trusts, and these structures are generally very similar to each other. Therefore, we request that the regulations clarify that both the Owner Trustee and the Beneficial Owner are covered by § 4261(e)(5), because (a) the Owner Trustee and the Beneficial Owner are both actual owners of the aircraft (the Owner Trustee is the legal owner, while the Beneficial Owner is the beneficial owner.), and (b) the Owner Trustee holds legal title, and the Beneficial Owner is a deemed owner under § 4261(e)(5)(C) by virtue of the operating agreement from the Owner Trustee. (The Owner Trust arrangements described above relate to business aircraft and not to aircraft operated by commercial airlines.)

(a) Beneficial Owner in an Owner Trust owns beneficial ownership interest in the aircraft.

As with other trusts, a trustee holds title to the trust asset(s) for the benefit of the trust beneficiary. Most owner trusts are established using a small number of aviation trust companies as trustees that qualify as U.S. citizens and are not related to the beneficial owners of such trust. The Beneficial Owner in an Owner Trust holds many of the attributes of aircraft ownership other than legal title. For example, the Beneficial Owner is entitled to any income and pays all expenses associated with the aircraft, has the upside benefit or downside risk as to the aircraft's value, bears all risk of loss, is treated as the owner of the aircraft for federal income tax purposes, and can decide when to sell the aircraft. Furthermore, under the operating agreement in an Owner Trust structure, the rent is typically a nominal amount or zero. The operating agreement only serves to document that the owner trustee has transferred control of the aircraft to the Beneficial Owner. This relationship is consistent with the Owner Trustee's status as a holder of only bare legal title to the aircraft. Since both the Owner Trustee and the Beneficial Owner are owners of interests in the aircraft, both should be eligible for the exemption in § 4261(e)(5).

(b) The lease has substance and is not a disqualified lease.

An Owner Trust for business aircraft describes the rights and responsibilities specific to the aircraft in an operating agreement between the Owner Trustee and the Beneficial Owner that is separate from, but closely related to the trust agreement. The operating agreement may contain explicit lease language or may instead use the term "license to use" and provides that the Beneficial Owner holds the exclusive right to lease or license and to possess, use and operate the aircraft. It also requires that the Beneficial Owner retain the crew and maintain the aircraft per FAA guidance and manufacturer's recommendations. The FAA recognizes the validity of operating agreements in owner trust structures.

FAA Notice of Policy Clarification for the Registration of Aircraft to U.S. Citizen Trustees in Situations involving Non-U.S. Citizen Trustors and Beneficiaries ("Policy Clarification") 78 Fed. Reg. 36,412, 36,416 (Jun. 18, 2013) states that ". . . a relationship established under a trust agreement is necessarily affected by an operating agreement or similar side agreement or arrangement involving trustee and trustor or beneficiary which allows possession and use of the aircraft at all times to remain with the trustor and/or beneficiary. The operating agreement and the trust agreement are so intertwined that the operating agreement could affect the relationship established under the trust."

Each trust agreement and related operating agreement are reviewed and approved by the FAA Aeronautical Center Counsel before the documents are recorded to confirm they are compliant with the applicable sections of the Code and Regulations and related guidance. Accordingly, the operating agreement is not a "disqualified lease." Whether termed lessee or licensee, the Beneficial Owner should be treated as a lessee of the aircraft and, therefore, a deemed owner under § 4261(e)(5)(C).

For both reasons ((a) and (b) above), the regulations should make it clear that the exception in § 4261(e)(5) applies to both the Owner Trustee and the Beneficial Owner.

Definition of Disqualified Leases – Prop. Treas. Reg. § 49.4261-10(b)(4)

Section 4261(e)(5)(C)(i) provides that the term "aircraft owner" includes a person who leases an aircraft other than under a "disqualified lease." Section 4261(e)(5)(C)(ii) defines the term "disqualified lease" for purposes of § 4261(e)(5)(C)(i) as a lease from a person providing aircraft management services with respect to the aircraft (or a related person (within the meaning of § 465(b)(3)(C)) to the person providing such services) if the lease is for a term of 31 days or less.

Prop. Treas. Reg. § 49.4261-10(b)(4) begins with the statement that "[t]he term *disqualified lease* has the meaning given to it by section 4261(e)(5)(C)(ii)." Prop. Treas. Reg. § 49.4261-10(b)(4) then continues with an anti-abuse provision stating that "[a] disqualified lease also includes any arrangement that seeks to circumvent the rule in section 4261(e)(5)(C)(ii) by providing a lease term that is greater than 31 days but does not provide the lessee with exclusive and uninterrupted access and use of the leased aircraft, as identified by the aircraft's airframe serial number and tail number."

The above referenced anti-abuse rule for disqualified leases significantly expands the application of a disqualified lease beyond the definition provided in the statute, ensnares common non-abusive situations that should not be subject to the rule, and circumvents the intended purpose of the statute.

First, the anti-abuse rule does not include language limiting its application to only a lease of an aircraft from a person providing aircraft management services for such aircraft (or a related person (within the meaning of § 465(b)(3)(C)) to the person providing such services). The regulation should be revised to include such a limitation since it is necessary to enable it to comport with the statutory requirements, and to limit the application of the rule to only those leasing arrangements described in the statute.

Second, the requirement in the proposed anti-abuse rule states that the lease should provide the lessee with exclusive and uninterrupted access and use of the leased aircraft. However, this ignores the fact that many aircraft are leased on a non-exclusive basis for valid business purposes such as liability protection, state sales and use tax compliance, and FAA regulatory requirements. As written, the anti-abuse rule would cause all leases in any structure that utilizes non-exclusive aircraft leases to be disqualified leases.

For example, suppose an entity purchases an aircraft and enters into two non-exclusive leases, one to its parent company and the second to a sister company, both with a term greater than 31 days. Under the proposed rule, both leases would be disqualified leases.

The proposed rule would also improperly subject entity based co-ownership structures to FET. For example, suppose two pilots form a limited liability company to purchase an aircraft. For FAA regulatory compliance reasons, the limited liability company enters into non-exclusive aircraft dry leases to each of the pilots who will operate the aircraft. Since neither lessee in such an arrangement would have exclusive and uninterrupted use of the aircraft, the proposed anti-abuse rule would cause those otherwise qualified leases to be disqualified leases.

Furthermore, the "for hire" language in the anti-abuse rule allows a lessee to use the leased aircraft to provide "for hire" flights. However, an aircraft must typically be leased to an on-demand air taxi operator to conduct such "for hire" flights. Thus, for reasons wholly unrelated to the air transportation excise tax, an aircraft owner may lease its aircraft without crew on a non-exclusive basis directly to an

on-demand air taxi operator in addition to leasing its aircraft without crew pursuant to a separate non-exclusive lease to a related party. In such a case, the aircraft will be leased to each lessee on a non-exclusive basis. Based on the language of the proposed rule, these facts could cause the non-exclusive leases to be disqualified leases. Therefore, the language of the proposed rule should be revised to address these issues to allow for the use of non-exclusive aircraft dry leases and for additional leases thereafter to qualify for the § 4261(e)(5) exemption.

Finally, under the proposed regulations, it is possible that an aircraft owner who provides limited services relating to the aircraft (e.g., aircraft insurance, hangar, etc.) could be deemed an aircraft management services provider based on the broad definition of the terms "aircraft management services" and "aircraft management services provider." Most business aircraft owners provide at least some services, such as insurance, hangarage, or maintenance, when they lease their aircraft for valid business reasons such as liability protection planning, maintenance consistency, insurance requirements, and state sales and use tax compliance.

Based on the example above, where an entity purchases an aircraft and enters into two non-exclusive leases to its parent company and to a sister company with a term greater than 31 days, the lessor may obtain the hangar and the insurance for the aircraft since there is typically one hangar and one insurance policy covering the aircraft even if there is more than one non-exclusive aircraft lessee. Under the proposed regulation as drafted, the lessor could be viewed as an aircraft management services provider and be subject to the anti-abuse rule with respect to disqualified leases. This scenario would inappropriately broaden the scope of the anti-abuse rule since the statutory language was not meant to apply the disqualified lease provision to lessors that provide only partial or limited services.

Based on this, we suggest that the anti-abuse rule be deleted as the statute limits the definition of a disqualified lease to a lease from a management company of 31 days or less. The overly broad proposed anti-abuse rule creates unnecessary complexity and precludes application of the § 4261(e)(5) exception in situations where Congress intended that it should apply.

If the IRS deems an anti-abuse rule is necessary, even after considering the above facts, it should be required to demonstrate that the taxpayer structured an arrangement that is, in substance, an on-demand air charter service with the principal purpose of avoiding the application of the disqualified lease rule. Furthermore, any such anti-abuse rule should delete the reference to nonexclusive leases and include a requirement that the lessor be primarily engaged in the aircraft management services business and that it provide pilots to operate the aircraft.

Fractional Aircraft Anti-Abuse Rule – Prop. Treas. Reg. § 49.4261-10(b)(3)(ii) and -10(i)

The anti-abuse rule contained in Prop. Treas. Reg. § 49.4261-10(b)(3)(ii) appears to be aimed at persons who attempt to create a structure providing access to a fleet of aircraft, which fails to meet the definition of "fractional ownership aircraft program" in I.R.C. § 4043, in an effort to avoid the fuel surtax imposed under 4043, while retaining the right to claim the exemption under § 4261(e)(5). However, it is unclear how this anti-abuse rule would apply to structures providing fleet access that exist for reasons unrelated to the applicability of the tax imposed under § 4043, and at what point a structure becomes enough like a fractional ownership aircraft program for the rule to apply.

The phrase "seeking to circumvent the surtax imposed by section 4043" indicates that, for the anti-abuse rule to apply, the primary *intent* in creating the arrangement must be to avoid the surtax. Thus, if there is a legitimate non-tax business purpose for creating the structure, the anti-abuse rule should not apply, and the exemption under § 4261(e)(5) should be available. In that scenario, the exemption would be applicable to amounts paid with respect to aircraft in which the owner had legitimate ownership or leasehold interest. Amounts paid by the owner for the use of other aircraft in the fleet would be treated as payments relating to substitute aircraft and subject to tax under Prop. Treas. Reg. § 49.4261-10(c). An attempt to increase the number of aircraft to which the exemption under § 4261(e)(5) applies by giving the owner a nominal ownership or leasehold interest could meet the *intent* requirement and trigger the anti-abuse rule.

Although only mentioned in Prop. Treas. Reg. § 49.4261-10(b)(3)(ii), and not in (i), another element of the anti-abuse rule appears to be that it only applies to certain structures, specifically those "that allow() an aircraft owner the right to use any of a fleet of aircraft (through an aircraft interchange agreement, through holding nominal shares in a fleet of aircraft, or any other similar arrangement)." It appears that this phrase is meant to apply to structures that are akin to fractional programs, but do not meet the definition of a fractional program in § 4043(c)(2).

However, as drafted, it could be misinterpreted to include various structures in which aircraft management services are provided, including (a) instances where a substitute aircraft is provided from the aircraft management services provider's charter fleet (which is addressed in Prop. Treas. Reg. § 49.4261-10(c)), (b) leasing structures where a lessor is providing an insured and maintained aircraft but no pilots (which would not have previously been subject to the tax under the possession, command and control test), and (c) the routine use of interchange agreements between aircraft owners. While fleet access may come in many forms, the type of fleet access that should be subject to this anti-abuse rule is access to aircraft that is created or arranged by an aircraft management services provider, and that includes pilot services.

To clarify both elements of the anti-abuse rule, we suggest revising the last sentence in Prop. Treas. Reg. § 49.4261-10(b)(3)(ii) adding the language in bold below:

> "Similarly, a participant in a business arrangement **created by an aircraft management services provider with the primary intent** to circumvent the surtax imposed by section 4043 by operating **aircraft including providing pilot and other management services** outside of subpart K of 14 CFR part 91, that allows an aircraft owner the right to use any of a fleet of aircraft (through an aircraft interchange agreement, through holding nominal shares **(less than 3% interests)** in a fleet of aircraft, or any other similar arrangement), is not an aircraft owner with respect to any of the aircraft owned or leased as part of that business arrangement. No such intent to circumvent the surtax shall be deemed to exist when the arrangement is entered into for valid non-tax business purposes."

We also suggest revising the first sentence in Prop. Treas. Reg. § 49.4261-10(i) as follows to cross-reference the above anti-abuse rule rather than confusingly appearing to create a separate anti-abuse rule:

"The exemption in section 4261(e)(5) does not apply to any amount paid for aircraft management services by a participant in the type of business arrangement described in paragraph (b)(3)(ii) that does not qualify the participant as an aircraft owner."

Finally, we suggest adding the following examples to subjection (j) of the regulation to illustrate when the anti-abuse rule would, and would not, apply:

(3) *Example 3 – (i) Facts.* Aircraft management services, including pilot services, are provided to participants in a program that does not meet the definition of fractional ownership aircraft program in section 4043(c)(2). Those services include access to a fleet of aircraft. Each participant is given a nominal ownership or leasehold interest in multiple aircraft, with the goal of having each participant primarily fly on aircraft in which that participant has an interest.

(ii) *Analysis.* Given that the program does not meet the definition of a fractional ownership aircraft program, neither the surtax under section 4043 nor the exemption under 4261(j) applies. Since the aircraft owner's access to the fleet of aircraft is part of the program created by the aircraft management services provider that includes pilot services and will include access to multiple aircraft in which the aircraft owner has an interest (which would fall outside of the definition of substitute aircraft), the anti-abuse rule may apply to this type of structure if the intent element is met. The fact that the operator of the program provides nominal ownership and/or leasehold interests in multiple aircraft to participants with the intent to have participants primarily fly on aircraft in which they have an interest indicates that the operator is attempting to maximize the potential applicability of the exemption under section 4261(e)(5) while avoiding the surtax under section 4043. This structure would trigger the anti-abuse rule, in which case the exemption under section 4261(e)(5) would not apply.

(4) Example 4 - (i) Facts. An aircraft is co-owned by two or more aircraft owners, and the owners elect to engage an aircraft management services provider to provide aircraft management services for the aircraft. The owners acquired the aircraft from a person unrelated to the management services provider. As part of the arrangement, the aircraft management services provider will also arrange for a substitute aircraft, as needed by each owner. The arrangement between the co-owners and the aircraft management services provider does not meet the definition of a fractional ownership aircraft program in section 4043(c)(2).

(ii) Analysis. Since the access to multiple aircraft is provided to the owners by the aircraft management services provider via a substitute aircraft subject to paragraph (c), the anti-abuse rule under paragraph (i) does not apply. Amounts paid by each aircraft owner to the aircraft management services provider for aircraft management services related to the aircraft owned by such owner are exempt under section 4261(e)(5). Amounts paid by each aircraft owner for the use of a substitute aircraft are subject to the taxes imposed by Section 4261, as provided in paragraph (c).

> *(5) Example 5 - (i) Facts.* Under two separate interchange agreements, aircraft owner A will provide access to the two aircraft it owns and pilots to aircraft owner B, in exchange for equal time on the two aircraft owned by aircraft owner B and pilots. Each aircraft owner will retain control of the aircraft it owns, and the pilots it provides, on all flights. Aircraft owner A and aircraft owner B each obtain some aircraft management services from an aircraft management services provider.
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> *(ii) Analysis.* Each aircraft owner is providing access to aircraft and pilots, the control of which will not be transferred to the other aircraft owner. Thus, the interchange agreements do not constitute leases for the purposes of qualifying B as an aircraft owner of A's aircraft under paragraph (b)(3)(i), and vice versa. Therefore, the exemption under section 4261(e)(5) would not apply to the amounts paid (including the value of the flights exchanged under the arrangement) by each aircraft owner to the other aircraft owner under the interchange agreements, and such payments would be subject to FET. However, the exemption under section 4261(e)(5) is available for the amounts paid by each aircraft owner for aircraft management services with respect to the aircraft it owns.

<u>Definition of Private Aviation – Prop. Treas. Reg. § 49.4261-10(b)(6)</u>

Prop. Treas. Reg. § 49.4261-10(b)(6) defines private aviation as all civilian flights except scheduled passenger service. Clearly, the intent is that the exemption should not apply to scheduled airline flights. As provided in Prop. Treas. Reg. § 49.4261-10(d), the exemption is available for flights conducted under the rules governing charter service under Part 135 of the FAA Regulations. Accordingly, we request clarification that "scheduled passenger service" refers to flights conducted by airlines that sell tickets on an individual seat basis to the general public. The term should not apply to charter flights operated under Part 135 of the FAA Regulations, which for the purposes of this section are private aviation.

<u>Charter Flights Provided to Owner – Prop. Treas. Reg. § 49.4261-10(d) and (e)</u>

The Preamble and the Proposed Regulations make it clear that payments by the aircraft owner for flights conducted on the owner's aircraft under Part 135 of the FAA Regulations should qualify for the exemption in § 4261(e)(5) in the same manner as payments by the owner for flights on the owner's aircraft under Part 91 of the FAA Regulations. However, these provisions in the Preamble and Proposed Regulations are contradicted by Prop. Treas. Reg. § 49.4261-10(e), and we suggest the revisions below.

The statute makes it clear that the amounts paid by the aircraft owner for "flights" on the owner's aircraft fall within the exemption in § 4261(e)(5). *See* § 4261(e)(5)(A)(ii).

In response to our previous comments on this issue, the Preamble, in the section captioned "Choice of Flight Rules" (85 Fed. Reg. 46,034), clearly states that the part of the FAA Regulations under which the aircraft is operated does not affect qualification for the exception in § 4261(e)(5). Likewise, Prop. Treas. Reg. § 49.4261-10(d) states that operation under Part 135, rather than Part 91 of the FAA Regulations, does not affect qualification for the exemption.

Therefore, it should be clear that payments by the owner for flights on the owner's aircraft qualify for the exemption when the flights are operated under Part 135 of the FAA Regulations.

This concern arises from the wording of Prop. Treas. Reg. § 49.4261-10(e). That section explains that qualification of owner flights for the exemption in § 4261(e)(5) is not affected by use of the aircraft by a charter operator "to provide for-hire flights (for example, when the aircraft is not being used by the aircraft owner . . .". The problem arises in the next sentence, which explains that for-hire flights are subject to FET. Our concern is that this sentence does not contain a carve-out for flights paid for by the aircraft owner and conducted under Part 135 of the FAA regulations, which could arguably be considered "for-hire" flights as defined in Prop. Treas. Reg. § 49.4261-10(b)(5).

Owners of private aircraft generally do not maintain a commercial air carrier certificate, and for purposes such as liability protection, often engage a certificated air charter operator to conduct flights under Part 135 of the FAA Regulations.

To confirm that payments by the owner for flights described above qualify for the exemption under § 4261(e)(5), we request that Prop. Treas. Reg. § 49.4261-10(e) be modified as follows:

> "However, an amount paid for for-hire flights on the aircraft owner's aircraft***, except payments made by such aircraft owner***, does not qualify for the section 4261(e)(5) exemption."

Substitute Aircraft – Prop. Treas. Reg. § 49.4261-10(c)

The proposed regulations provide that when an aircraft owner is provided flights on a substitute aircraft by the management company, a calculation is needed to determine the amount paid for such flights. We disagree with the need for this proposed calculation.

Assuming the flights provided on the substitute aircraft are correctly treated as charter flights provided by the management company to its customer and subject to FET, there is no need for a calculation to determine the amount paid for such flights. It is worth noting that the FAA requires, with few exceptions, that when a single source provides, directly or indirectly, both the aircraft and crew, the flight must be operated by a certificated air carrier.

Prop. Treas. Reg. § 49.4261-10(c) explains that flights on a substitute aircraft provided by the management company are taxable transportation, and amounts paid for such flights are subject to FET. However, rather than simply tax the amount paid for those flights, the proposed regulation requires a calculation whereby the amounts paid with respect to the owned aircraft are combined with the amounts paid for the flights on the substitute aircraft during the quarter. Then, the total cost is allocated to the flights on the substitute aircraft in proportion to flight hours of all aircraft (owned and substituted) during the quarter.

The calculation presented in the proposed regulations will ordinarily produce nonsensical results because the cost profile of the substitute aircraft will likely be different from the cost profile for the owner's aircraft. Averaging the costs of two aircraft with different cost profiles will produce an arbitrary result with no rational relationship to a reasonable, fair market charter rate for flights on the substitute aircraft. Also, the calculation will be further skewed if the taxpayer owns multiple aircraft with varying flight hours from one quarter to the next, buys or sells aircraft during the quarter, or pays various service providers rather than a single management company.

The more sensible method is calculating FET on the amounts paid for the charter flights on the substitute aircraft. If the amounts charged for the flights are below fair market charter rates, then FET should be calculated based on a fair market charter rate for a similar flight on a similar aircraft. If the substitute aircraft calculation cannot be removed, we suggest that the proposed regulations provide taxpayers the alternative of paying FET on the fair market value of the charter flights on the substitute aircraft. This alternative would be consistent with the fair market charter rate alternative presently available under Rev. Rul. 74-123, 1974-1 C.B. 318.

Fuel Tax on Owner Charters – Prop. Treas. Reg. § 49.4261-10(g)

Prop. Treas. Reg. § 49.4261-10(g) provides that flights subject to the management company exemption in § 4261(e)(5) are automatically non-commercial for fuel tax purposes.

This automatic classification of such flights as non-commercial for fuel tax purposes is contrary to the statutes and should be replaced with a regulation that follows applicable laws. This is particularly important for charter flights provided to the aircraft owner that, in some cases, might be classified as commercial for fuel tax purposes.

Section 4041(c)(3) provides that commercial fuel tax rates (4.4 cents per gallon outside of the CARES Act tax suspension) apply to "commercial" flights, while the non-commercial fuel tax rates (21.9 or 24.4 cents per gallon) apply to non-commercial flights. Under § 4083(b), a commercial flight is defined as air transportation provided for compensation or hire.

The IRS often states that "Congressional intent was 'to have the use of aircraft be subject either to the taxes on the transportation of persons and freight or else to the fuel taxes, but not to both as to any one trip.'" Prog. Mgr. Tech. Adv. 2018-020 (Oct. 5, 2018) (quoting S. Rep. No. 91-706, at 19 (1970)). This statement of Congressional intent instructs the IRS to be consistent in interpreting the definition of "commercial" for both the ticket tax and the fuel tax. However, in the case of a statutory exemption from the 7.5% ticket tax, the Congressional intent to interpret "commercial" consistently is not relevant. For example, in the case of the ticket tax exemptions under §§ 4261(h) and (i), 4281, and 4282, the corresponding provisions in § 4083(b) provide that non-commercial fuel tax rates apply. However, in the case of the ticket tax exemptions under § 4261(f) and (g), the corresponding provision in § 4041(*l*) provides an exemption from fuel tax.

In the case of the management company exception from the ticket tax under § 4261(e)(5), Congress did not provide a corresponding code section specifying whether the commercial or non-commercial fuel tax rates apply. Since this exception applies to owner flights irrespective of whether they are conducted in a commercial or non-commercial manner, the Congressional intent to interpret the term "commercial" consistently cannot apply to the determination of whether a particular flight subject to the exemption under § 4261(e)(5) is "commercial" for fuel tax purposes. If Congress had intended that all flights qualifying for the exemption under § 4261(e)(5) be treated as non-commercial flights for fuel tax purposes, Congress could have adopted a corresponding code section to that effect. Instead, Congress left the commercial or non-commercial fuel tax status of flights subject to § 4261(e)(5) to be determined under the general definition of "commercial" in § 4083(b).

Therefore, it is contrary to the statute for the regulations to provide that flights subject to § 4261(e)(5) are automatically non-commercial for fuel tax purposes, without considering whether they are correctly

classified as commercial under § 4083(b). Accordingly, Prop. Treas. Reg. § 49.4261-10(g) should be revised to provide that the determination of whether fuel used in such flights is subject to the commercial or non-commercial fuel tax rates should be determined under the definition of "commercial" under § 4083(b).

Status of CCA 2012-10026 – Prop. Treas. Reg. § 49.4261-10(j), *Example 1*

In 2012, the IRS issued Chief Counsel Advice 2012-10026 (Mar. 9, 2012). We request that the IRS withdraw that CCA because it is inconsistent with existing law and confusing to taxpayers.

In Scenario 1 in the CCA, the IRS essentially ruled that when a management company provides typical aircraft management services to a company that owns an aircraft, the management company is providing taxable transportation to the company. In our opinion, the CCA is now inconsistent with applicable law.

The CCA describes a typical management services arrangement, but in the legal analysis of that arrangement, the CCA states that the management company "exercises virtually all decision making." However, this is factually inconsistent with ordinary management services arrangements in which the aircraft owner makes the decisions.

The CCA states it is irrelevant that the owner (rather than the management company) owns the aircraft and decides when and where it travels. Far from being irrelevant, the fact that in a typical management services arrangement the aircraft is not provided by the management company, and the management company does not exercise the most important aspect of control over the aircraft, are critical to the distinction between providing mere personal services (which is typically the case) and providing transportation services (plane and pilot provided as a package).

The CCA further errs in Scenario 1 by stating it is irrelevant that the aircraft is operated under Part 91 of the FAA Regulations. We agree that under existing law, the part of the FAA Regulations governing the flight is not determinative of whether taxable transportation is provided. However, the FAA Regulations describe important rights, duties, and responsibilities that the owner and management company must comply with, and for that reason, they are relevant to the determination of whether the management company has possession, command, and control of the aircraft.

In addition, subsequent to the issuance of the CCA, the courts have ruled that whether a management company that is essentially in the position of the management company in Scenario 1 is providing taxable transportation is not clear and is subject to "genuine issues." *NetJets Large Aircraft, Inc. v. United States*, 80 F. Supp. 3d 743 (D. Ohio 2015) ("genuine issues"); *NetJets Large Aircraft, Inc. v. United States,* 116 A.F.T.R.2d 2015-6776 (D. Ohio 2015) (lack of "precise and not speculative" notice of collection responsibility).

Most importantly, through the TCJA, Congress indicated its intent with respect to aircraft managed for the benefit of owners by enacting the exemption in § 4261(e)(5). Accordingly, we request the withdrawal of the CCA.

Pilot Services – Prop. Treas. Reg. § 49.4261-10(j), *Example 1*

Prop. Treas. Reg. § 49.4261-10(j), *Example 1*, appears to state that if a company hires an aircraft management company to provide only pilot services to the company, then (absent the exemption in § 4261(e)(5)) the ticket tax would apply. This statement is far more extreme than the position taken in the CCA. The position advanced in the example appears to be that any company (apparently including a mere pilot services company) that provides the services of a pilot is deemed to have obtained possession, command, and control of the aircraft so as to provide taxable transportation service back to the aircraft owner.

This sentence (the second sentence in the example) should be deleted. In addition to being extreme, it is potentially a source of confusion regarding the application of the possession, command, and control test in situations that are not governed by § 4261(e)(5). Moreover, the sentence has no relevance to the rest of the example, which discusses the substitute aircraft situation.

Determination That Payments Are Made By Aircraft Owner – Prop. Treas. Reg. § 49.4261-10(a)(1), (3)

Prop. Treas. Reg. § 49.4261-10(a)(1) and (3) provide that the aircraft management services exemption of § 4261(e)(5) is only available when payments are "by an aircraft owner" and adequate records are maintained to support the use of the exemption. Given that this is a new concept, it warrants clarity for both management service providers and the IRS regarding the facts or evidence sufficient to show that the aircraft owner (or deemed owner) is the party making payments.

An aircraft management services provider, as a potential tax collector, must have clear and precise guidance on whether the exemption applies to a particular aircraft owner's payments. It is likely that in future audits, the aircraft management services provider will be asked to explain why it exempted certain payments from the otherwise applicable FET.

To make this exemption reasonably administrable, the regulations should provide that reasonable documentation from the aircraft owner stating that payments for management services originate from a source covered by the exemption in § 4261(e)(5) will satisfy the obligation to determine proper qualification for the exemption and adequate documentation.

Tax Collection Responsibilities – Prop. Treas. Reg. §§ 49.4261-1(b), -7(h), and 49.4263-3

In addition to our comments on Prop. Treas. Reg. § 49.4261-10, we understand the IRS is willing to consider comments on updates to regulations regarding payment and collection rules included as part of this rulemaking. We believe that the proposed regulations regarding FET collection responsibilities under § 4291 and liability for unpaid FET on audit pursuant to § 4263(c) are unclear and will result in continued confusion. We respectfully request that regulations provide greater clarity on these two issues, which will offer certainty to taxpayers regarding their collection and filing responsibilities and promote efficient tax administration.

(a) Requirement to Collect FET and File Forms 720

Prop. Treas. Reg. § 49.4261-1(b)(1) provides that the person receiving payment for air transportation service is the collector under § 4291 and must report the tax on Forms 720 and deposit the collected tax with the IRS. Prop. Treas. Reg. § 49.4261-7(h)(2) explains that if a charterer of a flight sells seats on the

flight, then the charterer must collect and remit FET from the passengers. In that case, the proposed regulation explains that the owner of the aircraft who sold the flight to the charterer has a duty to advise the charterer of the obligation to collect the tax from the passengers.

This approach of treating the ultimate buyer of the air transportation service as the taxpayer and treating the seller to that buyer as the collector is consistent with the approach generally taken in IRS rulings. See Rev. Rul. 68-256, 1968-1 C.B. 489. However, this brief guidance regarding charterers that resell transportation service does not address certain issues that arise in determining whether charter brokers are responsible for collecting FET and filing Forms 720.

In this regard, Rev. Rul. 75-296, 1975-2 C.B. 440, describes a travel agency (Agency A) that resells flights and has a duty to collect FET and file Forms 720. In contrast, another agency (Agency B) sells flights as an agent of the air carrier and has a duty to collect FET and turn it over to the air carrier, which then must file Forms 720. Furthermore, Rev. Rul. 2006-52, 2006-2 C.B. 761 describes an agency acting as a principal that facilitates the sale of flights between the air carrier and the passenger by acting as a mere conduit. One court case explains that the issue in determining whether an intermediary resells a flight is not whether the intermediary charters the entire aircraft. *Lake Mead Air, Inc. v. United States,* 991 F. Supp. 1209 (D. Nev. 1997).

Within the air charter industry, intermediaries chartering aircraft from the certificated air carrier performing the flights are referred to as brokers. These air charter brokers can act as agents of the carrier, agents of the passengers, or as principals in the transaction. Little guidance is provided in the above rulings on how to determine whether a particular charter broker arrangement is governed by one of the situations described. This lack of clear guidance has created considerable confusion in the industry. Accordingly, we request more precise regulations (presumably consistent with the above rulings) regarding the circumstances in which charter brokers or air carriers are obligated to collect FET and file Forms 720. Additional clarification is essential, particularly when viewed in conjunction with Prop. Treas. Reg. § 49.4261-1(b)(2), discussed below.

Finally, in describing the obligation to inform the charterer of its duty to collect the tax, proposed § 49.4261-7(h)(2) places this duty on the "owner of the aircraft." In the air charter industry, the air carrier does not typically own the aircraft used to provide charter flights. For this reason, we suggest using the term "air carrier" to avoid confusion about which party must advise a broker or other intermediary of their responsibility to collect and remit FET.

(b) Air Carrier's Liability for Tax Under § 4263(c)

Prop. Treas. Reg. § 49.4261-1(b)(2) explains that under § 4263(c), if FET is not collected, then the air carrier providing the initial flight segment in the U.S. is responsible for paying the tax. (Prop. Treas. Reg. § 49.4263-3 refers to § 49.4261-1(b) for rules regarding § 4263(c).) This obligation on the part of the air carrier to pay the FET if the party responsible for collecting it fails to do so creates considerable confusion and unfair liability exposure for the air carrier. For example, on audit, an IRS agent could assert air carrier liability for FET, when the carrier has no means to ascertain whether the tax has, in fact, been paid by another responsible party, such as a charter broker.

Compounding the problem is that Prop. Treas. Reg. § 49.4261-1(b)(1) appears to shift liability from the carrier to the charterer when the transportation is resold.

To alleviate the confusion and unfairness to air carriers, we suggest that the regulations provide that if an air carrier documents that it informed the charter broker of its obligation to collect FET and file Form 720, then the air carrier will not be liable for uncollected tax under § 4263(c).

Also, if the IRS asserts in an audit that an air carrier is liable for FET under § 4263(c) (irrespective of whether the carrier can show it informed the charter broker as described above), the air carrier is entitled to obtain information from the IRS on whether the asserted FET has been paid by the charter broker or any other party.

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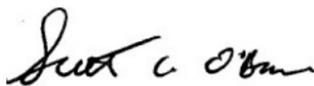
In conclusion, while we appreciate the significant efforts of the IRS and Department of the Treasury on this rulemaking project, we believe that modifications to Prop. Treas. Reg. § 49.4261-10 are necessary. The goal of our comments is to ensure that final regulations are consistent with the Congressional intent behind Section 13822 of the TCJA and that they accurately reflect current industry practice.

We look forward to meeting with you to answer any questions or provide additional clarification on our comments. Thank you for your consideration.

Sincerely,



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