

USA: federal excise taxes on air freight (a twisted logic game)

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The transportation of property by air is subject to a special federal excise tax (FET) on the amount paid for such air transportation services but the FET can be difficult to comply with, as this article explains.¹

I. Introduction

The transportation of property by air is subject to a special 6.25 percent federal excise tax (FET) on the amount paid for such air transportation services.

The FET on transportation of property by air can be difficult to comply with. In fact, the IRS itself recently needed help and advice from its Office of Chief Counsel to answer (and not answer) three seemingly straightforward questions — (1) Who is the Collector of FET? (2) Who is the Taxpayer responsible for paying FET? and (3) What is the tax base upon which FET is calculated? The Chief Counsel's answers (and non-answers) are both illuminating and troubling for taxpayers trying to run businesses and also comply with ambiguous tax laws, the violation of which can result in additional taxes, interest and penalty payments.

II. FET background

The Internal Revenue Code imposes FET of 6.25 percent on the amount paid for taxable transportation of property by air. Generally, FET is paid by the person making the payment subject to tax (the Taxpayer), and the person receiving any payment for transportation of property by air (the Collector) is required to collect FET from the Taxpayer and remit the tax to the IRS. The Collector is personally at risk for its failure to fully collect and remit the FET due to the IRS.

The Collector must be a person engaged in the business of transporting property by air for hire, and FET only applies to amounts paid to the Collector. For example, amounts paid to an air carrier by a freight forwarder or express company for the transportation of property by air are subject to FET, but FET does not apply to amounts paid by a customer (i.e. shipper) to a freight forwarder or express company. Accordingly, FET does not apply to amounts paid to a person that facilitates or otherwise arranges the transportation of property by air unless that person is directly engaged in the business of transporting property by air for hire.

III. FET at work

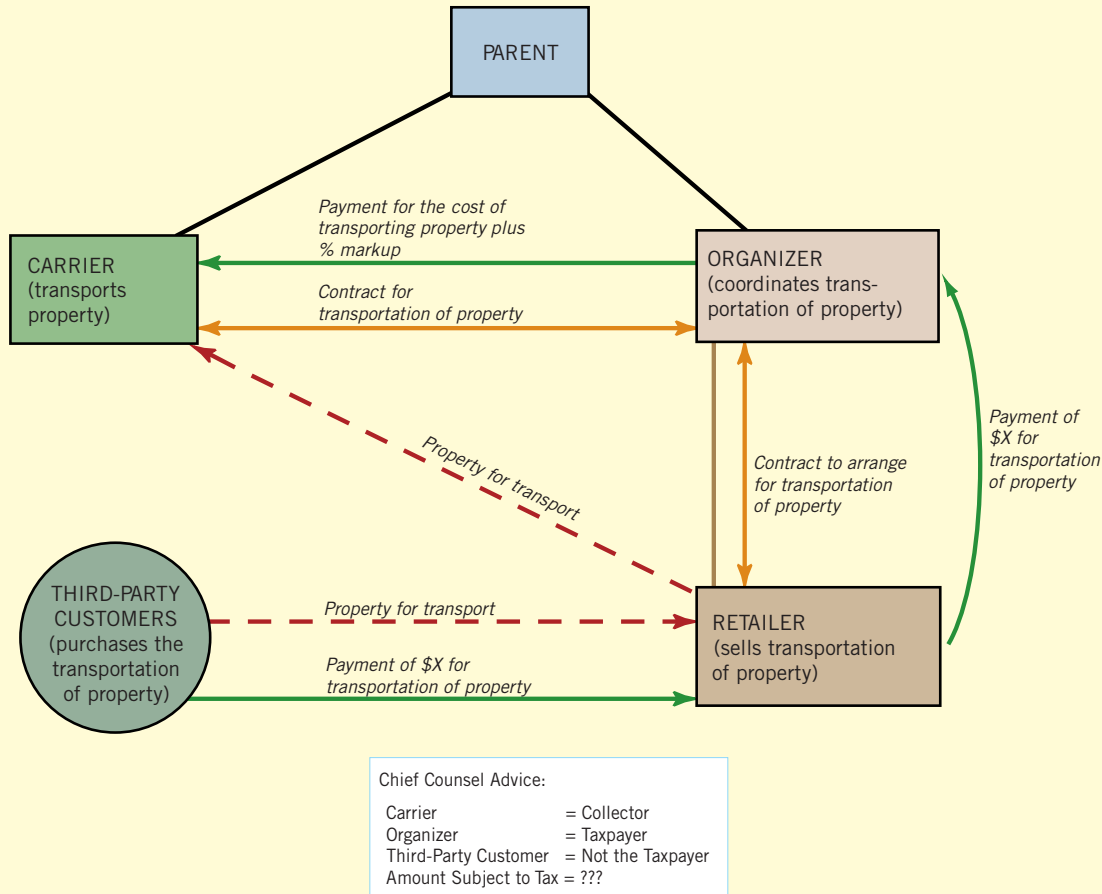
The IRS Office of Chief Counsel recently provided guidance (in CCA 201123027) that highlights the FET compliance difficulties faced by taxpayers.

The facts presented to the IRS concern a conventional air freight business where the operations are divided into three separate entities, all under common control by a parent corporation (the Parent). One entity (the Carrier) is engaged in the air transportation business and owns, leases, operates and maintains a large number of aircraft (the Carrier). A second entity (the Retailer) acts as the interface with customers (the Customers) that are shipping goods. The third entity (the Organiser) coordinates all aspects of transporting the property from origin to destination, including scheduling and volume management.

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Federal Excise Tax on Transportation of Property by Air

(CCA 201123027)



The Customers pay fees to the Retailer for shipping their property. If the delivery plan includes the use of aircraft, the Retailer allocates and remits the entire Customer fee to the Organizer (and the Retailer charges the Organizer for ground transportation costs). The Organizer, under its contracts with the Carrier, reimburses the Carrier for air transportation costs, plus a percentage markup. The Organizer enters into agreements with the Carrier and the Retailer to accomplish the foregoing, and the Organizer, Carrier and Retailer all operate under the same brand name as a single delivery service of the Parent. The intra-company contracts and payments are invisible to the Customers who simply pay the Retailer. This operational structure is represented by the chart above.

This division of corporate activity has obvious benefits from an organisational standpoint, but creates a challenge when trying to apply FET. The facts presented raised two questions that the IRS Chief Counsel answered: (1) who is the Collector (i.e. the person engaged in the business of transporting property by air for hire), and (2) who is the Taxpayer (i.e. the person making the payment subject to FET)?

The IRS concluded that, for purposes of paying FET on transportation of property by air, the Carrier (not the Organizer) is the Collector of FET, and the Organizer (not the Customer) is the Taxpayer responsible for

paying FET. However, the IRS did not determine the tax base on which the 6.25 percent FET is to be applied. How did this all come to be?

IV. Who is the collector of FET?

FET only applies to amounts paid for taxable transportation of property by air that are paid to a person engaged in the business of providing transportation of property by air for hire. So, to determine who is the Collector of FET — the Carrier or the Organizer — the IRS asks (and answers) two questions: (1) who provides the taxable transportation of property by air, and (2) who is engaged in the business of transporting property by air for hire?

First, the IRS determined that the Carrier provides taxable transportation of property by air because the Carrier (not the Organizer) retains “possession, command and control” of the aircraft used to transport the property. The Carrier provides the aircraft, pilots, mechanics and maintenance. However, the Organizer controls what cargo the Carrier transports, the aircrafts’ destinations, overloading and unloading of cargo, and the timing of departures and other scheduling decisions. Ultimately, the IRS determined that the Organizer’s power was not “possession, command, and control” of the aircraft for purposes of determin-

ing who provides the taxable transportation of property by air when compared to the Carrier's control over the aircraft. The Carrier owns (or leases) the aircraft, employs the pilot and crew, and provides the services of the pilot and crew with the aircraft under the terms of the agreements with the Organiser. Accordingly, the Carrier retains the essential elements of "possession, command, and control" and is the person that provides taxable air transportation irrespective of the fact that the Organiser directs other details concerning aircraft flights. The IRS further determined that the Organiser was not an agent under the supervision and control of the Carrier, merely related parties, and thus the Organiser was not responsible to collect FET as an agent for the Carrier.

Second, the IRS determined that the Carrier (not the Organiser) is a person engaged in the business of transporting property by air for hire with respect to property transported for the Organiser, and thus the Carrier is the Collector that is required to collect FET from the Taxpayer. This is an interesting determination because a Customer may not be aware that the Carrier is the person that provides the service; the Carrier sells a minimal amount of cargo space to the public, and the Organiser exercises a great deal of control over the timing, destination and other aspects of the Carrier's services. Viewed objectively, the business model took the customary role of an air freight company and split it three ways, among the Carrier, Organiser and Retailer, and the IRS had to determine which entity was tasked with collecting FET. The IRS was forced to conclude that the Carrier is engaged in the business of transporting property by air for hire because FET only applies to amounts paid to a person engaged in the business of transporting property by air for hire.

V. Who is the taxpayer responsible for paying FET?

Somewhat oddly, the IRS determined that the Taxpayer responsible for paying FET is the Organiser, which is the sister company of the Carrier. The Customers actually paying for the transportation of their property by air are not the Taxpayers responsible for paying FET. The IRS appears to have backed into this result based upon its determination above that the Carrier is the Collector.

Under the tax law, FET due on amounts paid for transportation of property by air is paid by the person making the payment subject to the tax, which is the person making the payment to the person engaged in the business of transporting property by air for hire, which according to the IRS is the Carrier. The Organiser entered into agreements with the Carrier to pay for transportation of property by air, the Carrier bills the Organiser for its services and the Organiser effectuates the transfer of funds for the services. Since the Organiser is a "person" making the payment to the Carrier, the IRS concluded that the Organiser is the Taxpayer responsible for paying FET. The determination that the Customers are not the Taxpayers, and

thus not responsible for paying FET, could have some interesting, unintended consequences that are generally beyond the scope of this article, but one is worth exploring now.

VI. What is the tax base upon which FET is calculated?

After concluding that the Carrier is the Collector and the Organiser is the Taxpayer, the IRS left the last and most interesting question unanswered — what is the tax base upon which FET is calculated? Is the tax base the amount that the Organiser pays the Carrier or the greater amount that the Customer pays the Retailer? The IRS acknowledged that, although the calculation of the tax base was not under consideration in this case, generally, the "amount pays" for taxable transportation of property by air must relate to a payment for air transportation.

Logically, the tax base upon which FET is calculated appears to be the amount paid by Organiser to Carrier, which would be less FET collected than if the IRS determined that the tax base is the amount paid by the Customers to the Retailer. However, the IRS appears to be constrained from going after the larger tax base by its determination that the Organiser is the Taxpayer. If the IRS concluded that the Customers are the Taxpayers, then it would follow that no FET was due on the Customers' payments to the Retailer because the Retailer is not a person engaged in the business of transporting property by air for hire, and this FET only applies to payments to such persons.

VII. Never mind (when it comes to FET on transportation of persons by air)

Do not think that the IRS's determination in this case on the 6.25 percent FET on transportation of property by air can easily be applied to the 7.5 percent FET on transportation of persons by air. The IRS both cited to, and distinguished, the FET on transportation of persons by air in resolving the property transportation tax issues in CCA 201123027. In particular, when determining that the Carrier was the Collector (and not the Organiser or the Retailer), the IRS was clear to point out that the tax law on transportation of property by air is different than the law on transportation of persons by air because FET on transportation of property by air applies "only to amounts paid to a person engaged in the business of transporting property by air for hire." The statute is designed to make the person actually engaged in the business of transporting property by air the person responsible for collecting the tax.

In contrast, when it comes to FET on transportation of persons by air, the IRS will, under certain circumstances, seek to require other persons (such as travel agents and charter brokers) to collect FET on transportation of persons by air, not just the persons engaged in the business of transporting persons by air for hire. Unlike FET on transportation of property by

air, the IRS warns that a person does not have to be engaged in the business of taxable transportation by air in order to expose himself/herself to the responsibility for collecting FET as a person who received payment for transportation of persons by air.

VIII. Conclusion

Federal excise taxes on transportation of property and persons by air are complicated, counterintuitive and seemingly inconsistent, as clearly evidenced by the above. Consulting with tax counsel is certainly advisable, and seeking a private letter ruling from the IRS is the best way to know that FET laws are being complied with.

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This is a publication providing general news about recent legal developments and should not be construed as providing legal advice or legal opinions. You should consult an attorney for any specific legal questions.

NOTES

¹ The author would like to alert readers that at the time of publication, FET on the transportation of property and persons by air has expired due to Congressional inaction on FAA reauthorization legislation. However, it is expected that Congress will reinstate FET in the future.