



Charter Tax:

Reducing Federal Excise Taxes on private aircraft charter services.

by Gary I. Horowitz

The great tragedy of the U.S. tax system is that it encourages, and rewards complexity. It may seem counterintuitive, but when it comes to Federal Excise Taxes (FET) on air transportation services, Simple = Expensive, and Complex = Cost Savings.

Instead of yelling into the wind at this obvious inefficiency, private aircraft charter operators can embrace the reality and, with the IRS's blessing, reduce its charter customers' FET burden by breaking down charter operator services into their component parts. Under a new IRS private letter ruling, the IRS categorized 39 different air carrier services as either a "transportation service" subject to FET, or a "non-transportation service" exempt from FET. This IRS ruling contains nuggets of opportunity that a charter operator could use to lower its customers' overall costs.

Generally, amounts paid for taxable transportation of any person by air are sub-

ject to FET of 7.5%, plus segment fees. The person paying for the taxable transportation (the customer) is liable for the tax and the person providing the taxable transportation (the air carrier) is required to collect and remit the tax to the IRS.

FET is measured by the total amount paid for "taxable transportation," which is transportation by air that begins in the United States or in the 225-mile zone and ends in the United States or in the 225-mile zone. The term "transportation" includes layover or waiting time and movement of aircraft in deadhead service. However, Treasury regulations and other IRS guidance specifically exclude (or include) amounts paid for certain types of services from FET.

Under current Treasury Regulations, FET does not apply to the following and similar charges: (1) charges for transportation of baggage, including incidental charges such as excess value, storage, transfer, parcel checking, special delivery, etc., and (2)

charges for admissions, guides, meals, hotel accommodations, and other non-transportation services such as, for example, where such items are included in a lump sum payment for an all-expense tour.

If a customer's payment covers charges for both transportation and non-transportation services, the non-transportation charges must be separable and shown in the exact amounts thereof in the records pertaining to the transportation charge, or FET is computed based upon the full amount of the payment.

Although there is no definition of "non-transportation services," such services generally relate to meals, entertainment and hotel accommodations. Therefore, an amount paid for any non-transportation service is not included in the FET tax base, provided the recordkeeping requirements are met. By contrast, payments for services that are subject to FET include amounts paid as additional charges for changing the destination, or route, "extra fare," or for

exclusive occupancy.

The Treasury regulations do not address all of the different possible transportation and non-transportation services available. When the Treasury regulations provide no guidance as to whether FET applies to a particular service, the IRS has determined that the FET tax base is limited to amounts paid for "mandatory" charges, such as a security charge which is part of the amount paid for taxable transportation because it is required as a condition to receiving air transportation.

The IRS has also determined that FET should not apply to any service charges (1) that are optional, (2) not reasonably necessary to the air transportation itself, and (3) that bear a reasonable relation to the cost of providing the service. For example, an amount paid to access an airport's premium lounge is not required to be paid as a condition to receiving air transportation, thus an amount paid for this type of service is not subject to FET.

In 2010, the IRS released PLR 201002004, which ruled that optional air carrier services, and air carrier services that do not relate to air transportation, including baggage fees, are not taxable transportation subject to FET.

This recent IRS ruling on FET, which was issued to a commercial air carrier, included several FET liability exemptions, including the following:

1. Amounts paid by customers to an air carrier for baggage handling for checked luggage, including overweight and oversized baggage, are not taxable.
2. Amounts paid by customers for assistance in making travel plans, purchasing tickets, either in person or on the telephone (as opposed to using the air carrier's website) are optional services, and therefore not taxable.
3. Amounts paid for providing customers the option of purchasing food and alcoholic beverages and headsets to be used for in-flight entertainment are non-taxable non-transportation services.
4. Amounts paid for the following are not conditions to receiving air transportation and therefore not taxable:
 - Providing customers with access to the air carrier's premium airport lounges on a daily or annual basis.
 - Allowing customers to purchase non-refundable gift cards that can only be applied to the purchase of future air transportation (the gift cards are not issued in the exact amount of the fare, do not state an itinerary, and do not themselves entitle the bearer to air transportation).



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- When the customer was a member (Member) of the air carrier's frequent flyer program, fees relating solely to the maintenance of the Member's frequent flyer account (Account) with the air carrier.
- Providing Members with a printout of their Account details.
- Providing details and records of a Member's Account to an outside third party.
- Providing Members with password protection for Account inquiries made by telephone.
- Providing Members with personalized luggage tags.

Charter operators have the opportunity to apply these FET liability exemptions to their own, customized services to reduce their customers' FET costs. Instead of charging customers a flat, hourly rate in which transportation and non-transportation services are lumped together, charter operators can prepare customer invoices that clearly distinguish between its taxable

transportation services and non-transportation charges, thereby reducing the amount of FET that would otherwise be owed when no distinction is made between transportation and non-transportation services.

When the customer's payment covers charges for both transportation and non-transportation services, the non-transportation charges must be separable and shown in the exact amounts in the records pertaining to the transportation charge. The non-taxable "non-transportation services" will be all amounts paid for services that are optional, not reasonably necessary to the air transportation itself, and that bear a reasonable relation to the cost of providing the service.

Whether any particular service is considered transportation or non-transportation is subject to IRS scrutiny, and so delineating between the two should be done carefully and with the assistance of qualified tax counsel.

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