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Maverick Alaskan Court Protects Taxpayer From IRS Air Transportation Excise Taxes

In addition to king crab and snowmobiling governors, Alaska has independent-minded courts. The U.S. District Court for the District of Alaska recently prevented an overreaching effort by the IRS to subject a scenic tour operator to federal air transport excise taxes.

The taxpayer, NorthStar Trekking, LLC, specialized in air tours and had a Part 135 Certificate authorizing it to operate charter flights. NorthStar chartered its aircraft, on-demand, on an hourly basis and offered flight-seeing tours on a per seat basis. NorthStar also provided flight-seeing charters to cruise ship passengers through agreements with the cruise lines.

In 2004, the IRS decided that NorthStar owed federal air transport excise taxes (FET) for flight-seeing charters it flew during 2002. NorthStar protested the assessment, arguing that it was exempt from taxation because it operated helicopters of 6000 pounds or less, its flight-seeing charters were not operated on an “established line,” and that it had no duty to collect and pay FET.

IRC § 4261(a) imposes a 7.5% federal excise tax on amounts paid for taxable transportation of persons by air. However, there is an exemption from this tax under IRC § 4281 for transportation by an aircraft having a maximum certificated takeoff weight of 6,000 pounds or less, except when such aircraft is operated on an established line. Effective for transportation provided after September 30, 2005, this exemption was expanded to expressly provide that an aircraft shall not be considered as operated on an established line at any time during which such aircraft is being operated on a flight the sole purpose of which is sightseeing. The change, however, did not apply to NorthStar’s flights in 2002.

The key legal question for the Court was whether NorthStar's 2002 flights were operated on an “established line” under IRC § 4281. The Court cited to Treas. Reg. § 49.4263-5, which provides that the term “operated on an established line” means operated with some degree of regularity between definite points, and that the term implies that the person rendering the service maintains and exercises control over the direction, route, time, and number of passengers carried.

The Court concluded that NorthStar's flights were not operated on established lines because the flights' duration, destination, and general route were determined and controlled by the cruise line and cruise ship passengers, and the flight destinations were different glacier landings that varied depending upon the weather, glacier surface changes, and multiple other conditions. The Court rejected the government's argument that NorthStar would have run regular flights for the general public regardless of cruise ship passengers because 90% of NorthStar's customers came from the cruise ships. Also, the fact that NorthStar's pilots physically controlled the helicopters during the flights did not create

an "established line" because the customers dictated the flight times, destinations and general routes, which was the determining factor for the Court.

The "small aircraft on nonestablished lines" exception under IRC § 4281 that is cited by the Court is one of several FET exceptions that we advise our clients on using in order to minimize FET liabilities in the flight planning stages and during IRS audits.

For more information, please contact Gary Horowitz at 301-800-0001, or ghorowitz@hchlegal.com.