# New IRS Guidance:
## Aircraft management fees subject to transportation excise taxes

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**A recent memorandum issued by the Chief Counsel of the Internal Revenue Service potentially has significant ramifications for companies using the professional services of aircraft management companies. Attorney Keith Swirsky examines the issue for Boardroom readers.**

On March 9, 2012 the IRS Office of Chief Counsel released a Chief Counsel Advice memorandum (CCA) in which the IRS concluded that, with respect to aircraft operations conducted under FAR Part 91, control of an aircraft's pilots is a primary factor in determining which party has "possession, command and control" of an aircraft for purposes of imposing transportation excise taxes imposed under Internal Revenue Code Section 4261 (FET).

Based on the facts described in the CCA, the IRS determined that virtually all fees and reimbursements paid by an aircraft owner to its aircraft management company, for flights conducted under FAR Part 91, are subject to Federal Excise Tax (nominally 7.5 percent) when the aircraft management company has primary control of the aircraft's pilots, among other things.

In the July and August 2011 issues of *World Aircraft Sales Magazine* we explained the law concerning Federal Excise Taxes as well as the IRS' audit position. Since that time, the only substantive change that has occurred is that the pace of IRS audits of aircraft management companies has accelerated and now, of course, auditors can refer to the CCA as their mandate. To date, however, we are aware of no court decisions that have been rendered in suits pertaining to disputed audits.

Prior to the issuance of the CCA, IRS auditors relied on rulings issued by the IRS since the 1950s containing facts and analysis that are generally more pro- ›



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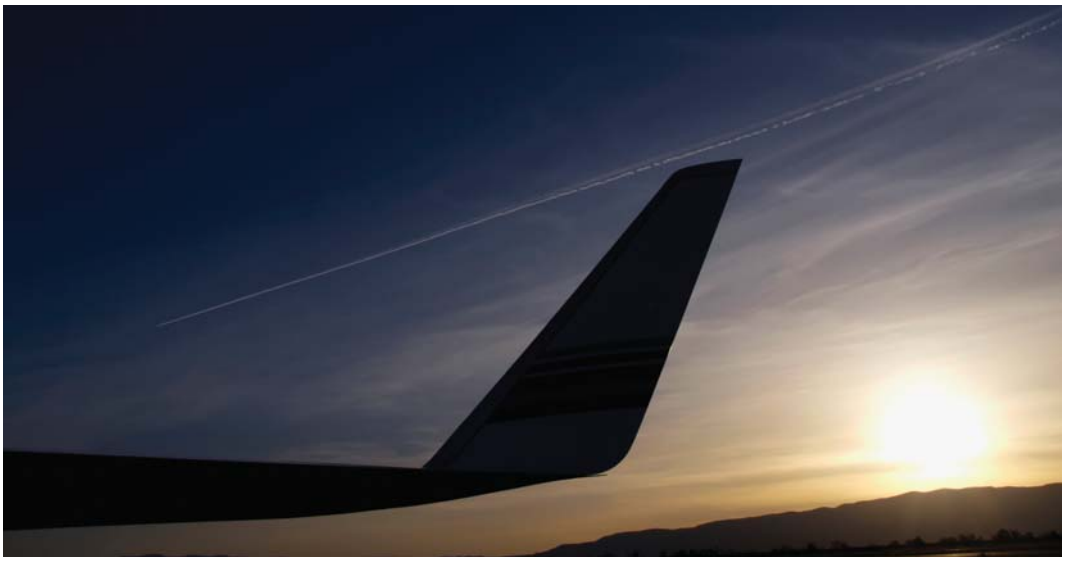

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taxpayer than the CCA position. As a result of the recent CCA memorandum, however, it is likely that a substantial majority of IRS auditors, who generally have limited experience auditing aircraft management companies, will commence such action with the bias that management fees (and other reimbursements) paid by an aircraft owner to an aircraft management company are subject to FET.

To make matters worse, IRS auditors are asserting that the conclusion reached in the CCA is retroactive to all open tax years. If the IRS imposes FET on amounts collected by management companies for past years, the financial burden on management companies will be very harsh and the effects of this will reverberate throughout the Business Aviation community.

## OVERREACTION

From our perspective, it appears that the IRS is overreaching with its conclusions in the CCA. The memorandum states that a management company has possession, command and control of an aircraft where it "exercises virtually all decision making with regard to the operation and maintenance of the aircraft" and where "the operational authority that the owner exercises over the aircraft is limited to selecting flight destinations."

Aircraft management companies typically provide aircraft owners with comprehensive services for a fee and receive reimbursements from owners for coordinating third party vendor services. Despite the fact that many management agreements are drafted with an explicit statement that "the management company is an independent contractor, and not the agent of the owner," this provision is normally drafted to reflect state law considerations, and does not reflect the actual relationship of the parties.

Notwithstanding standard language in management agreements designed to ensure compliance with FAA regulations, to provide liability protection and to address non-tax commercial law objectives, as a practical matter a management company acts solely at the direction and control of an aircraft owner. A typical aircraft management agreement may generally be terminated on very short notice in the event the owner is dissatisfied with the services provided by the management company.

It is our strong position that the IRS does not understand the practical relationship between a management company and an aircraft owner. Based on the standards articulated in the CCA, the IRS is likely to assert an FET liability under a traditional management relationship despite the existence of this principal-agent relationship between an aircraft owner and the management company.

The National Business Aviation Association and the National Air Transportation Association are working with both the IRS and Congress to resolve these issues. Until such time as these issues are resolved, it is prudent for aircraft management companies and owners to modify their agreements to clarify the role of the management company as the agent of the owner and to emphasize the substantial control the owner has over the day-to-day management and operations of the aircraft.

It is essential that the parties address the issues identified in the CCA memorandum and prior IRS rulings that support the conclusion that an aircraft owner has possession, command and control of its aircraft. In addition to the foregoing, an aircraft owner should consider paying third party vendors directly to minimize amounts paid by the owner to the management company.

While there is no guarantee that the IRS could not assess FET on such amounts, it is certainly a "belt and suspenders" approach that may lower the amount that is potentially subject to the FET in the event of an adverse tax audit assessment. We will continue to update readers upon future developments regarding this important subject.

**Do you have any questions or opinions on the above topic? Get them answered/published in World Aircraft Sales Magazine. Email feedback to: Jack@avbuyer.com**


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