



Market Segment Specialization Program



Aviation Tax

The taxpayer names and addresses shown in this publication are hypothetical. They were chosen at random from a list of names of American colleges and universities as shown in *Webster's Dictionary* or from a list of names of counties in the United States as listed in the *United States Government Printing Office Style Manual*.

This material was designed specifically for training purposes only. Under no circumstances should the contents be used or cited as authority for setting or sustaining a technical position.



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Market Segment Specialization Program Guide**

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Chapter 1

Introduction to the Aviation Market Segment

Background

The aviation market segment includes all persons involved in commercial and noncommercial air transportation. This group includes but is not limited to

- Scheduled commercial airlines,
- On-demand air taxi services,
- Charter airlines,
- Integrated package delivery companies,
- Travel agencies and tour brokers,
- Businesses and individuals that operate aircraft for their own use,
- Individuals who purchase airline tickets, and
- Marketers of fuel that is used in aircraft.

The Internal Revenue Code (IRC) imposes taxes on both commercial and noncommercial aviation. For flights in *commercial aviation*, a tax is imposed on amounts paid for the transportation of persons by air (IRC section 4261) and property by air (IRC section 4271). Also, commercial aviation is burdened by a relatively small fuel tax on aviation gasoline (IRC sections 4081 and 6421) and aviation fuel (other than gasoline) (IRC section 4091). For flights in *noncommercial aviation*, a much higher rate of tax on fuel is imposed.

Whether commercial or noncommercial aviation taxes apply is determined on a flight-by-flight basis. Determining which set of taxes applies to which flights is a recurring audit issue. Determining the amount paid for commercial transportation is another recurring audit issue.

Aviation taxes go into the Airport and Airway Trust Fund (IRC section 9502). Expenditures from the fund support the Federal Aviation Administration (FAA).

This document serves as a self-study text and a market segment specialization guide for examiners. The contents of this document are not to be used or cited as authority for setting or sustaining a technical position.

Great caution should be used in applying existing regulations and revenue rulings to present fact situations. The IRC section 4261 regulations, which were last revised in 1963, do not reflect the many changes in the Code since that time. Similarly, many revenue rulings contain out-of-date tax rates and do not reflect the significant changes made in the Code in 1996 and 1997.

Outside Stakeholders

A partial list of outside stakeholders is provided below.

Trade Associations

- General Aviation Manufacturers Association (manufacturers of airplanes)
- Air Transport Association of America (airlines)
- International Air Transport Association (international airlines)
- Air Transport Association of Canada (Canadian carriers)
- National Business Aviation Association (corporate air operations/business plane users)
- National Air Transportation Association (air charter and freight companies)
- Aircraft Owners and Pilots Association (owners and pilots)
- Regional Airline Association (regional carriers)
- U.S. Air Tour Association (air tour operators)
- Helicopter Association International (helicopter carriers)
- Hawaiian Helicopter Tour Operators Association
- U.S. Parachute Association (skydiving enthusiasts and drop zone operators)
- Association of Air Medical Services (air ambulances)
- American Association of Airport Executives (airport operators)

Federal Agencies

- Federal Aviation Administration (Recipient of Airport and Airway Trust Fund)

FAA Certificates (Licenses)

The types of certificates (licenses issued by the FAA) are:

- Part 91: Noncommercial (that is, no profit motive rather than the IRS definition of no compensation),
- Part 121: Large carriers of passengers and freight,
- Part 125: Large corporate aircraft and large aircraft used for gambling junkets,
- Part 129: Foreign carriers, and
- Part 135: Small carriers of passengers and freight.

The FAA defines commercial aviation as the carriage of persons or property by air for profit. Compare this to the IRS definition, which simply requires that the carriage be undertaken for compensation. The differing definitions have caused confusion among some aircraft operators. Flight departments often assume that, since a flight is not considered commercial for FAA purposes, the flight is not considered commercial for

tax purposes. However, the IRS is not bound by other agencies' definitions. Rev. Rul. 78-75, 1978-1 C.B. 340 states that the status of an aircraft operator as a "commercial operator" under FAA regulations does not determine the commercial or noncommercial status of the operator in the application of the aviation fuel and air transportation taxes.

Air Transportation Excise Issue Specialist Program

The November 1991 Excise Tax Task Force Report addressed the need to move to a market segment approach in the excise tax arena. Corporate decisions were made to integrate market segment approaches throughout all compliance activities. The establishment of a work group to address the air transportation industry was the beginning of the implementation of the market segment approach to excise tax. Members of the work group were selected on the basis of their work, technical experiences, training, and background.

Each member of the work group is responsible for providing advice, assistance, and technical expertise to agents in the planning and conduct of examinations. Please feel free to request assistance from the work group whenever you feel it would be appropriate. This assistance can be in the form of information, advice, or if necessary, physical assistance at the examination sites. The workgroup members develop market segment audit techniques and guidelines, update and revise the *Internal Revenue Manual*, lead or participate in technical conferences, and submit articles to trade publications. In addition, the group advises IRS Headquarters on issues and practices in the application of the law, emerging issues, changes in technology, and innovative audit techniques from the field.

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Chapter 2

Return Filing and Deposit Requirements And Blind Credits

Filing Requirements

Fuel Taxes

Forms 720, Quarterly Federal Excise Tax Returns, for aviation fuels taxes (both aviation gasoline and aviation fuel other than gasoline) are required for each calendar quarter. They are due on the last day of the month following the close of the quarter. (Treas. Reg. section 40.6071(a)-1(a)(1))

Air Transportation Taxes

Returns are due 2 months after the close of the quarter when other Forms 720 are due one month after the end of the quarter. (Treas. Reg. section 40.6071(a)-2)

Multiple Taxes

If a taxpayer is required to file returns for two or more taxes with different due dates, the return is due on the later of the due dates. For example, if a taxpayer is required to file a return for both aviation fuel and transportation of persons by air, the return is due on the last day of the second month after the close of the quarter. (Treas. Reg. section 40.6071(a)-1(a)(2))

Deposit Requirements

Form 720 Schedule A ties deposits to the tax liability.

Electronic Deposit Requirements

The taxpayer must make electronic deposits for *all* depository taxes that occur after 1997 if

- Total deposits of income tax withheld and Social Security, Medicare, and Railroad Retirement taxes were more than \$50,000 in 1996, or
- Total deposits of other depository taxes (such as excise tax) exceeded \$50,000.

Electronic Federal Tax Payment System

The Electronic Federal Tax Payment System (EFTPS) must be used to make electronic deposits. If the taxpayer is an employer required to use EFTPS, he or she

must also use EFTPS to deposit excise taxes.

Taxpayers who are not required to make electronic deposits may voluntarily participate in the EFTPS Program.

Federal Tax Deposit Coupons

If the taxpayer is not required to use EFTPS and does not voluntarily participate in the EFTPS Program, he or she should deposit federal excise taxes at an authorized depository or the Federal Reserve Bank servicing the area in which he or she is located.

When To Make Deposits

Taxes that are required to be deposited are grouped into the following classes:

- 9-day-rule taxes
- 30-day-rule taxes (not covered in this guide)
- Alternative method taxes
- 14-day-rule taxes

If the taxpayer deposits more than one tax in a class, he or she should combine all the taxes in the class and make one deposit for the semimonthly period.

9-Day Rule

The deposit of tax for a semimonthly period is due by the 9th day following that period. Generally, this is the 24th day of a month and the 9th day of the following month. The 9-day rule applies to all taxes in Part I of Form 720 except for

- Gasoline and diesel fuel tax (IRS Nos. 14, 60, 62, 58, 73, 74, 59, 75, and 76), if deposits by qualified persons are made using EFTPS. (See “14-Day Rule” below.)
- Air transportation taxes (IRS Nos. 26, 27, and 28) if deposits are based on amounts billed or tickets sold, rather than on amounts actually collected. (See “Alternative Method” below.)

Alternative Method (IRS Nos. 22, 26, 27, and 28)

Deposits of communications and air transportation taxes may be based on amounts billed or tickets sold during a semimonthly period instead of on taxes actually collected during the period. Under the alternative method, the tax included in amounts billed or tickets sold during a semimonthly period is considered collected during the first 7 days of the second month following semimonthly period. The deposit of tax is due by the 3rd banking day after the 7th day of that period.

For example, the tax included in amounts billed or tickets sold for the period from

December 16, 1997, to December 31, 1997, is considered collected from January 16, 1998, to January 22, 1998, and must be deposited by January 27, 1998.

To use the alternative method, you must keep a separate account of the tax included in amounts billed or tickets sold during the month and reported on Form 720. The tax is included in amounts billed or tickets sold, not the amount of tax that is actually collected. For example, amounts billed in December, January, and February are considered collected during January, February, and March and are reported on Form 720 as the tax for the 1st quarter of the calendar year.

14-Day Rule (IRS Nos. 14, 60, 62, 58, 73, 74, 59, 75, and 76)

Deposits of the gasoline and diesel fuel tax for a semimonthly period by an independent refiner or any person whose average daily production of crude oil for the preceding calendar quarter did not exceed 1,000 barrels may be made by the 14th day following the semimonthly period. The deposits must be made using EFTPS. If the 14th day is a Saturday, Sunday, or legal holiday, the due date is the immediately preceding day that is not a Saturday, Sunday, or legal holiday. The 14-day rule does not apply to dyed diesel fuel used in trains (IRS No. 71) or to dyed diesel fuel used in certain intercity or local buses (IRS No. 78).

Delayed Deposits

The following deposits have a delayed deposit due date of October 5, 1998:

- Deposits of fuel taxes (IRS Nos. 60, 62, 58, 69, 73, 74, 59, 75, 76, 14, 69, and 77), and transportation of property by air (IRS No. 28), that would be due after July 31, 1998, including the September rule deposit due September 28 or 29, 1998, and before October 1, 1998
- Deposits of transportation of persons by air (IRS No. 26) and use of international travel facilities (IRS No. 27) that would be due after August 14, 1998, including the September rule deposit due September 28 or 29, 1998, and before October 1, 1998

Amount To Deposit

Deposits of taxes for a semimonthly period must be at least the net tax liability for that period, unless one of the safe harbor rules applies. The safe harbor rules apply separately to deposits under the 9-day rule, the 30-day rule, the alternative method, and the 14-day rule.

The net tax liability for a semi-monthly period is the total liability for the period plus or minus any adjustments for the period. Net tax liability for a semimonthly period may be figured by dividing the net tax liability for the month by 2, provided this method of computation is used for all semimonthly periods in the calendar quarter.

Under the alternative method, the deposit of tax for any semi-monthly period must not be less than the net amount of tax that is considered collected during the semi-monthly period. The net amount of tax that is considered collected during the semi-monthly period must be

- The net amount of tax reflected in the separate account for the corresponding semimonthly period of the previous month, or
- One-half of the net amount of tax reflected in the separate account for the preceding month.

Safe Harbor Rules

There are two safe harbor rules:

- The look-back quarter liability
- The current liability

Requirements To Be Met

For the safe harbor rules to apply, the taxpayer must:

1. Make each deposit timely at an authorized Government depository, and
2. Pay any underpayment for the current quarter by the due date of the return.

However, if the due date of the return is extended because the taxpayer reports taxes with different return due dates, he or she must deposit on the earlier due date any underpayment for taxes ordinarily reported on the earlier date.

The Look-Back Quarter Liability Safe Harbor Rule

The look-back quarter safe harbor rule applies to persons who filed a Form 720 for the look-back quarter (the 2nd calendar quarter preceding the current quarter). Persons who filed for the look-back quarter are considered to meet the semimonthly deposit requirement if the deposit for each semimonthly period in the current quarter is at least $\frac{1}{6}$ (16.67 percent) of the net tax liability reported for the look-back quarter.

For the semi-monthly period for which the additional deposit is required, the additional deposit must be at least 12.23 percent (11.12 percent non-EFTPS) of the net tax liability reported for the look-back quarter. Also, the total deposit for that semi-monthly period must be at least $\frac{1}{6}$ (16.67 percent) of the net tax liability reported for the look-back quarter.

Exceptions

The look-back rule does not apply to:

- The 1st and 2nd quarters beginning on or after the effective date of an increase in the rate of tax unless the deposit of taxes for each semi-monthly period in the calendar quarter is at least 1/6 (16.67 percent) of the tax liability that would have been incurred for the look-back quarter if the increased rate of tax had been in effect for that look-back quarter; or
- Deposits of any tax if the tax was not in effect throughout the look-back quarter.

The Current Liability Safe Harbor Rule

The current liability safe harbor rule applies to all filers of Form 720. Filers are considered to meet the semi-monthly deposit requirement if the deposit for the semi-monthly period is at least 95 percent of the net tax liability for the semi-monthly period.

For the semi-monthly period for which the additional deposit is required, the additional deposit must be at least 69.67 percent (63.34 percent non-EFTPS) of the net tax liability for the semi-monthly period. Also, the total deposit for that semi-monthly period must be at least 95 percent of the net liability for the semi-monthly period.

Blind Credits

If the air carrier elects to report the tax and make deposits based on the alternative (tickets sold) method, Treas. Reg. section 40.6302(c)-3(b)(ii)(2) requires that the carrier separately account for the tax. For each month, the account must reflect all items of tax that are included in amounts billed or tickets sold during the month and items of adjustment relating to the tax for the prior months. The carrier then reports and deposits the net, which is referred to as a “blind credit.”

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Chapter 3

Fuel Taxes

Introduction

Two types of aviation-related fuels are taxed by the IRC: aviation gasoline and aviation fuel (other than gasoline).

“Aviation gasoline” (avgas) is a high octane specialty gasoline product that is usually used only in small, piston-driven aircraft. Most avgas is dyed blue or green.

“Aviation fuel” (other than gasoline or diesel fuel) is usually kerosene-based and is often referred to as “jet fuel,” “kero-jet,” or “jet-A.” Aviation fuel, which is always clear, is used in all commercial jets, corporate jets, and turbo-prop commercial aircraft. References in this document to “aviation fuel” are references to aviation fuel other than gasoline.

Aviation Fuels Other Than Gasoline

Background

Before April 1, 1988, IRC section 4041(c) imposed a tax when any liquid other than gasoline was sold by a retailer and delivered into the fuel supply tank of an aircraft in noncommercial aviation or used as such a fuel by a buyer who purchased the fuel in a nontaxable transaction.

Since April 1, 1988, tax has been imposed by IRC section 4091 on the sale of *aviation fuel* by the *producer* or importer thereof. *Producers* include registered wholesale distributors. Registered producers may make tax-free sales to other registered producers. Thus, in practice, the tax usually is not imposed until a registered wholesale distributor sells the fuel to a retailer at an airport (often referred to as a “fixed-base operator” or “FBO”) or to the user of the fuel.

There are no regulations under IRC section 4091. Instead, agents and taxpayers may rely upon the following notices for guidance:

- Notice 88-30, 1988-1 C.B. 497, which provides rules for making tax-free sales of aviation fuel to producers of aviation fuel
- Notice 88-132, 1988-2 C.B. 552, which provides rules for making tax-free and tax-reduced sales of aviation fuel for certain aviation fuel uses
- Notice 89-38, 1989-1 C.B. 679, which defines wholesale distributor
- Notice 89-17, 1989-1 C.B. 647, which defines aviation fuel for periods before March 14, 1996 (The notice was declared obsolete on that date in T.D. 8659.)

Definitions

Aviation Fuel. Any liquid (other than gasoline or diesel fuel) that is suitable for use as a fuel in an aircraft. (IRC sections 4093(a), 4081(a), and 4083(a)(1))

Importer. A person who brings aviation fuel into the United States from a source outside the United States or who withdraws aviation fuel from a customs-bonded warehouse for sale or use in the United States. If the nominal importer of the fuel is not its beneficial owner (for example, the nominal importer is a customs broker engaged by the beneficial owner), the beneficial owner is the importer of the fuel. (Treas. Reg. section 48.0-2(a)(4) (i))

Producer. This includes, but is not limited to, any person who has been registered by the IRS with respect to the IRC section 4091 taxes and is (1) a refiner, blender, or wholesale distributor of aviation fuel or (2) a dealer who sells aviation fuel exclusively to producers of aviation fuel. In addition, any person to whom aviation fuel is sold at a reduced rate is treated as a producer of such fuel. (IRC section 4093(b))

Wholesale Distributor. According to Notice 89-38, 1989-1 C.B. 679, a person who meets one of the following three tests:

1. The person holds himself or herself out to the public as being engaged in the trade or business of selling aviation fuel to producers, retailers, or users who purchase in bulk quantities and accept delivery into bulk storage tanks; *and* at least 30 percent of the *number* of the person's sales of aviation fuel during the year are to producers, retailers, or users who buy in bulk quantities for their bulk tanks.
2. The person actually makes more than "casual sales" of taxable fuel to producers, retailers, or users who purchase in bulk quantities and accept delivery into bulk storage tanks. The person is considered to have actually made more than casual sales if (1) at least 30 percent of his or her *number of* sales in the preceding 12 months were to such purchasers, or (2) at least 50 percent of the *volume* of aviation fuel is sold to such purchasers, and at least 500 of his or her sales during the year were made to such buyers.
3. The person holds himself or herself out to the public as being engaged in the trade or business of selling aviation fuel for nontaxable uses (such as use on a farm for farming purposes or use in foreign trade) and sells at least 70 percent of his or her *volume* of aviation fuel during the year for such uses.

For tests 1 and 2, a bulk storage tank is a container that holds at least 50 gallons and is not the fuel supply tank of any engine on an aircraft. The term "bulk quantities" means 25 gallons or more.

Imposition of Tax

IRC section 4091(a)(1) imposes a tax on the sale of aviation fuel by the producer or the importer thereof or by any producer of aviation fuel. If any producer uses aviation fuel (other than for a nontaxable use) on which no tax has been imposed by IRC section 4091, then such use is considered a sale.

The producer selling or using the fuel is liable for tax.

Additionally, IRC section 4103 provides that, in any case in which there is a willful failure to pay the tax, each person:

- who is an officer, employee, or agent of the taxpayer who is under a duty to assure the payment of the tax and who willfully fails to perform such duty, or
- who willfully causes the taxpayer to fail to pay the tax

is jointly and severally liable with the taxpayer for the tax to which such failure relates.

Collection Division guidelines for IRC section 4103 are found in section 56(50) of the IRM 5600.

Tax Rates

The following table lists the tax rates on aviation fuel since 1994. All taxable sales of aviation fuel are entered on IRS No. 69, *unless* a sale was for use by the buyer in commercial aviation (IRS No. 77). The discussion under “Exemptions” below explains when the rate for commercial aviation applies.

Quarter	Aviation Fuel IRS No. 69	Commercial Use Of Aviation Fuel IRS No. 77
Jan. 1994	.219	.001
Apr.	.219	.001
July	.219	.001
Oct.	.219	.001
Jan. 1995	.219	.001
Apr.	.219	.001
July	.219	.001
Oct.	.219	.044
Jan. 1996	.043	.043
Apr.	.043	.043
July	.043	.043
Aug. 27, 1996	.218	.043
Oct.	.218	.043
Jan. 1997	.043	.043

Quarter	Aviation Fuel IRS No. 69	Commercial Use Of Aviation Fuel IRS No. 77
Mar. 7, 1997	.218	.043
Apr.	.218	.043
July	.218	.043
Oct.	.219	.044

Exemptions

Sales to Producer

Under IRC section 4092(c), tax is not imposed on aviation fuel sold to a producer of such fuel. Section IIIB(1)(c) of Notice 88-30 provides that, "This provision applies only if --

- (i) Both the seller and the buyer are registered under IRC section 4101 with respect to the tax imposed by IRC section 4091;
- (ii) The buyer has notified the seller in writing with which district director the buyer is registered and the Certificate of Registry number (now letter of registration number) of the buyer; and
- (iii) The buyer's registration number appears on the invoice for each tax-free sale made to the buyer."

In this context, *invoice* includes an invoice, purchase order, or other record of sale that is maintained by the seller in the normal course of business. (Section IA of Notice 88-30)

Producers apply for registration by the IRS on Form 637, Application for Registration (For Certain Excise Tax Activities). A bond may be required as a condition of registration. The bonding rules are set forth in section V of Notice 88-30. A taxpayer registered by the IRS as a producer of aviation fuel is assigned a registration number with an "H" suffix.

Sales for Nontaxable Uses

Under IRC section 4092(a), tax is not imposed on a producer's sale of aviation fuel for use by its buyer for a use that is exempt from the tax imposed by IRC section 4041(c)(1). These uses are:

1. Use other than as a fuel in an aircraft;
2. Use as a fuel in an aircraft on a farm for farming purposes (as that term is defined

in Treas. Reg. section 48.6420-4);

3. Use as a fuel in an aircraft in foreign trade (as that term is used in Treas. Reg. section 48.4221-4) or trade between the United States and any of its possessions;
4. Use as a fuel in an aircraft owned by the United States or any foreign nation and constituting equipment of the armed forces thereof;
5. Exclusive use of a state or local government;
6. Export or shipment to a possession of the United States;
7. Exclusive use of a nonprofit educational organization (as that term is defined in Treas. Reg. section 48.4221-6);
8. Use as a fuel in an aircraft by an aircraft museum (as described in IRC section 4041(h)(1)) for the procurement, care, or exhibition of aircraft of the type used for combat or transport in World War II; and
9. Use as a fuel in an aircraft of the type and for a purpose described in IRC section 4261(e) or (f).

The IRC section 4261(e) exemption applies to helicopters engaged in the exploration for or the development or removal of hard minerals, oil, or gas and in timber (including logging) operations if the helicopters neither take off from nor land at a facility eligible for Airport Trust Fund assistance or otherwise use federal aviation services during flights. In the case of helicopter flights for hard minerals, oil, or gas, each flight segment is treated as a distinct flight.

The IRC section 4261(f) exemption applies to any air transportation for the purpose of providing emergency medical services (1) by helicopter or (2) by a fixed-wing aircraft equipped for and exclusively dedicated on that flight to acute care emergency medical services.

The IRC section 4261(e) and (f) rules were modified in 1996 and 1997. In a case involving such issues, be aware of the dates on which the aviation fuel in question was sold.

Section IV of Notice 88-132 generally provides that a producer may make a tax-free sale for any nontaxable use if the producer receives a described exemption certificate from the buyer.

Reduced Rate Sales for Domestic Commercial Aviation

Under IRC section 4092(a) and (b), tax is imposed at a reduced rate on a producer's sale of aviation fuel for use by a buyer in domestic commercial aviation.

Section IV of Notice 88-132 generally provides that a producer may make such reduced-rate sales if the producer receives a described exemption certificate from the buyer. As an additional requirement, the buyer (the airline) must be registered by the IRS.

Airlines apply for registration by the IRS on Form 637. A bond may be required as a condition of registration. The bonding rules are set forth in section V of Notice 88-30. A taxpayer that is registered by the IRS as a buyer of aviation fuel for use in commercial aviation is assigned a registration number with a “Y” suffix.

Note that some large commercial airlines that are registered as producers of aviation fuel have registration numbers with an “H” suffix. These airlines may buy all their aviation fuel tax free. If one of these airlines then uses the fuel in domestic commercial aviation, the airline is liable for the aviation fuel tax at the reduced rate.

A producer that makes a sale subject to this rate of tax enters gallons and tax on Form 720, IRS No. 77.

Credits and Refunds

A credit or refund is allowable to the ultimate purchaser of taxed aviation fuel if the aviation fuel is used in a nontaxable use. Such refund claims are made on Form 8849, Claim for Refund of Excise Taxes, and generally must be made by the last day of the quarter following the last quarter included in the claim. A refund claim for the claimant’s fourth quarter of its income tax year is not allowed, even if the claim is made on Schedule C of Form 720. Claims not taken as refund claims may be allowable as income tax credits on a Form 4136, Credit for Federal Tax Paid on Fuels.

Also, IRC section 4091(d) provides that if a registered producer buys aviation fuel on which tax has been paid to the Government (and not credited or refunded), then an amount equal to the tax is allowable as a refund (without interest) to the producer just as if the amount were an overpayment of the IRC section 4091 tax. IRC section 4091(d) applies to fuel acquired by the producer after September 30, 1997.

Potential Audit Issues

Potential audit issues include:

- Failure of the producer to pay the tax in a “daisy chain” evasion scheme;
- Sales of fuel for noncommercial aviation on which tax was paid at the commercial aviation rate (Taxpayers frequently dispute whether a particular flight is in commercial or noncommercial aviation.);
- Improper credit or refund claims, including claims made for taxable uses, claims for the same fuel made on both Form 8849 and Form 4136, claims made for the

claimant's fourth quarter, and blind credits taken on Form 720; and

- Failure to include a credit or refund in gross income if the claimant claimed the amount as an expense deduction that reduced his or her income tax liability.

Examination Techniques

Because the federal excise tax (FET) for aviation fuel is imposed on either the seller or the user and there is a potential for many persons to incur this liability, consider some of the suggestions listed below under "Seller" and "User" during your examination.

Seller

1. If tax-free aviation fuel sales were made, verify that (1) the sales were made to registered purchasers or (2) the sales were accompanied by appropriate exemption certificates.
2. Inspect the business location.
3. Inspect the retained copy or copies of the dealer's state returns when appropriate.
4. Look at the nontaxable sales reported.
5. Check for large bulk sales. Follow through to the purchaser.
6. Verify reporting of FET on all fuels being sold.
7. Make a secondary FET computation by using the dealer's state returns and total pump reading sales. If the dealer is selling in more than one state, check the dealer's returns for all states.
8. Determine whether (1) the business or owner(s) operate any aircraft or (2) the owner(s) operate any aircraft that would be subject to special fuels tax.
9. Determine if (1) the state allows an evaporation deduction and (2) if an evaporation deduction has been entered on the Federal return.

User

1. Inspect purchase invoices for tax-paid or tax-free purchases and note where the fuel is being purchased.
2. Determine how the information on use is being recorded.
3. Inspect retained copies of the user's state returns if applicable.

If your state's fuel records are available to you, they should periodically be checked against your annual alphabetical listing of Form 720 filers. Some districts have this done by a computer audit specialist; others do it manually. Whichever method is used, you will find that checking state records is a productive method of obtaining delinquent returns. Moreover, in some states, you may be able to gain access to state records and compare the gallons reported to the state with the gallons reported on the Form 720.

4. The required periodic compliance checks of Form 637 registrants provide an opportunity to find out to whom a registrant has been selling aviation fuel tax-free. The sales should then be followed to ensure that the buyers filed Forms 720 if there was a taxable use.
5. While inspecting the purchase invoices for aviation fuel of a person who is not registered on Form 637, determine whether his or her supplier has passed on these taxes to the buyer. If the taxes have not been passed on, there are generally no excise tax consequences to the buyer; but you may consider auditing the supplier since this may indicate that the supplier is not paying the tax.
6. Determine whether any claim for refund was filed. If the claimant used tax-paid aviation fuel in commercial aviation, then a credit or refund is available.

Aviation Gasoline

Under IRC section 4081, certain removals, entries, or sales of gasoline (including aviation gasoline) are subject to tax. Before January 1, 1996, gasoline that was used in noncommercial aviation was taxed not only by IRC section 4081 but also by IRC section 4041. The IRC section 4041 tax generally was imposed when the gasoline was delivered into the fuel supply tank of the aircraft, and the seller was liable for tax. If the buyer bought the gasoline in a nontaxable transaction and then used it in noncommercial aviation, then the buyer was liable for the retail level tax.

Effective August 27, 1996, the IRC section 4041 tax was repealed, and a specific rate of tax was imposed on aviation gasoline by IRC section 4081. Thus, tax now is imposed on aviation gasoline only by IRC section 4081, but the rate imposed on aviation gasoline is different from the rate imposed on highway gasoline.

Imposition of Tax

IRC section 4081 imposes tax on certain removals, entries, or sales of aviation gasoline. In practice, tax is imposed when the gasoline is removed from a terminal at the terminal rack. The position holder with respect to the gasoline is liable for this tax. Rules for gasoline tax liability are set forth in Treas. Reg sections 48.4081-1 through 48.4081-3.

The rules of IRC section 4103, which are described under “Aviation Fuel,” also apply to aviation gasoline.

Tax Rates

The following table lists the rate of tax on gasoline and aviation gasoline since 1994:

Quarter	Gasoline IRS No. 62	Noncomm. Aviation IRS No. 14
Jan. 1994	.184	.01
Apr.	.184	.01
July	.184	.01
Oct.	.184	.01
Jan. 1995	.184	.01
Apr.	.184	.01
July	.184	.01
Oct.	.184	.01
Jan. 1996	.183	0
Apr.	.183	0
July	.183	0
		Aviation Gasoline
Aug. 27, 1996	N/A	.193
Oct.	N/A	.193
Jan. 1997	N/A	.043
Mar. 7, 1997	N/A	.193
April	N/A	.193
July	N/A	.193
Oct	N/A	.194

Exemptions

As with all gasoline (other than gasoline blendstocks), there are no exemptions from the IRC section 4081 tax on aviation gasoline based on the intended use of the gasoline.

Credits and Refunds

Claims by Taxpayers and Wholesale Distributors

Generally, if aviation gasoline is sold for a use listed below under “Use on a Farm for Farming Purposes,” a credit or refund is allowable to the person who paid the tax to the Government, as indicated in IRC section 6416(b)(2). However, see IRC section 6414(a)(4) and Notice 89-29 for the conditions under which such claims must be made by a gasoline wholesale distributor.

The uses to which this rule applies include:

- Use by a state or local government,
- Use by a nonprofit educational organization,
- Use in military aircraft, and
- Use in foreign trade.

Alternatively, IRC section 6420(c) allows these claims to be made by the ultimate purchaser of the gasoline.

Use on a Farm for Farming Purposes

Under IRC section 6420, an income tax credit is allowable to the ultimate purchaser of aviation gasoline used on a farm for farming purposes. The term “used on a farm for farming purposes” is defined in Treas. Reg. section 48.6420-4.

The use of gasoline in the aerial application of fertilizer, pesticides, or other substances is use of gasoline on a farm for farming purposes. If someone other than the farmer performs this service, the farmer is still considered the ultimate purchaser of the gasoline. However, the farmer may waive the right to obtain the credit as described in Treas. Reg. section 48.6420-4(1).

Other Uses

A credit or refund is allowable to the ultimate purchaser of aviation gasoline that is used in commercial aviation, used in an off-highway business use, or used in certain aircraft as described in IRC sections 4261(e) and (f). (See the discussion of these provisions under “Aviation Fuel.”) All of these claims may be for the full amount of tax that was imposed on the aviation gasoline *except* for aviation gasoline used in commercial aviation.

Examination Techniques

The audit techniques suggested for aviation fuels other than gasoline may also be used for sellers of aviation gasoline.

Fuel Used in Commercial Aviation

Before October 1, 1995, there was no tax on fuel used in commercial aviation. The Omnibus Budget Reconciliation Act of 1993 (OBRA 93) imposed the 4.3 cents per gallon deficit reduction rate on these fuels for the first time, but the tax on commercial aviation fuels did not go into effect until October 1, 1995.

Keep in mind that the exemption for supplies for vessels and aircraft applies to international commercial flights.

Under IRC section 4092(b), aviation fuel may be sold at a reduced rate of 4.3 cents per gallon for use in an aircraft used in commercial aviation.

Producers cannot sell at the reduced tax rate to commercial aircraft operators after January 31, 1989, unless such operators are registered on Form 637 (Category Y).

Effective October 1, 1997, the 4.3-cent tax goes to the Trust Fund instead of the General Fund.

Floor Stocks Tax

Fuel tax laws and rates have changed many times over the past decade. Any change in the point of taxation or increase in rates creates a need to impose a floor stocks tax. The most recent floor stocks tax with respect to aviation gasoline and other aviation fuels diesel applies to inventories as of March 7, 1997. This floor stocks tax was due on August 1, 1997.

Only the most recent floor stocks tax is covered here.

A floor stocks tax is imposed on previously taxed aviation gasoline and nongasoline aviation fuel held by any person at the first moment of March 7, 1997. A person holds fuel if the person has title to the fuel (whether or not delivery to that person has been made) at such time. The rate is 15 cents per gallon for aviation gasoline and 17.5 cents per gallon for fuels other than gasoline.

The floor stocks tax does not apply to fuel held exclusively for an exempt use or fuel held for use in commercial aviation.

The floor stocks tax does not apply if the aggregate amount of fuel does not exceed 2,000 gallons. Fuel held for exempt use or for use in commercial aviation is not counted for purposes of determining the aggregate amount of fuel.

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Chapter 4

Collected Taxes

Introduction

The facilities and services taxes (communications taxes and air transportation taxes) apply to an amount charged for a facility furnished or a service rendered. These taxes are reported on Form 720 and are classified as collected taxes. These taxes are paid by the person who receives the service or uses the facility, but they are collected and remitted to the Government by the person providing the service or use of the facility.

Remember that the customer is the taxpayer and the carrier is the collecting agent.

Collected vs. Noncollected Taxes

The essential difference between a collected and noncollected tax is that a noncollected tax is imposed directly on the seller (taxpayer), who must pay it whether or not the customer ultimately pays it. All excise taxes are noncollected taxes except those imposed on facilities and services. A collected tax is levied against parties paying for the service or use of the facility, but the company or agency who sells the service has the duty to collect the tax from the parties and file the Form 720 reporting the tax.

The term “collected tax” stems from the fact that the person furnishing the facility must act as a collecting agent for the tax imposed on the person paying for the facility or service.

The person paying for the service or facility is liable for the tax at the time of payment. Once payment is made to the person required to collect the tax, the amount collected is held to be a special fund in trust for the United States. The amount of such a fund is assessed, collected, and paid in the same manner and subject to the same provisions applicable to the taxes from which the fund arose.

If the person furnishing the facility or service does not collect the tax, the person who paid for the service or the use of the facility is liable, and the tax may be assessed directly against that person.

The Taxpayer Relief Act of 1997 amended IRC section 4263(c) to provide that, if the tax under IRC section 4261 is not paid at the time the payment for transportation is made, the tax must be paid by the carrier providing the initial segment of transportation that begins or ends in the United States. Thus, the carrier is secondarily liable for the tax on the transportation of persons by air. This provision is generally effective for amounts paid on or after October 1, 1997, for travel on or after October 1, 1997.

Administrative Procedures for Collected Taxes

References

- IRM 4700, Excise Tax Procedure, Sections 4742 and 4784.2(4)
- Rev. Rul. 58-300, 1958-1 C.B. 454; amplified by Rev. Rul. 59-306, 1959-2 C.B. 422
- Treas. Reg. section 301.6601-1
- IRC section 6672 and Treas. Reg. section 301.6672-1

Procedures

Transportation of Persons by Air When the Carrier Is Secondarily Liable

When it is determined that the carrier is secondarily liable, the deficiency will be proposed against the carrier.

Transportation of Property by Air or Transportation of Persons by Air When the Carrier Is Not Secondarily Liable

The duty to collect the collected taxes is imposed on the collecting agencies. However, the consumer or taxpayer is not relieved of his or her liability for the tax. Even though the collecting agency has failed to collect the tax, liability does not shift to the collecting agency. We still must look to the consumer for the tax.

Generally, we will ask the collecting agency to collect the “back taxes” due from the customers. Most of them try to comply.

The procedures can be found in IRM 4742 (8-10-94).

Trust Fund Recovery Penalty

IRC section 6672 provides for a 100-percent penalty when the collecting agency willfully fails to collect, truthfully account for, or remit collected taxes. When willfulness is indicated, the case is referred to the Collection Division for a determination of the applicability of IRC section 6672.

If the Collection Division accepts the case, it will assess the penalty. The penalty is used as a collection device, and no tax is assessed if the penalty is collected.

If the Collection Division declines to pursue the penalty, the examiner is to proceed with the procedures in IRM 4742 (8-10-94).

Chapter 5

Transportation of Persons by Air

Introduction

IRC section 4261(a) imposes a tax on the amount paid for taxable transportation of any person. In the case of amounts paid outside the United States for taxable transportation, the tax imposed applies only if such transportation begins and ends in the United States. IRC 4261(b) extends this tax to any amount paid for seating or sleeping accommodations on or in connection with transportation under IRC section 4261.

The person who pays for the ticket pays the tax. The person receiving the payment must collect the tax and file the return. Tax is reported on Form 720, IRS No. 26.

For transportation on or after October 1, 1997, IRC section 4261(c) imposes a tax of \$12 on any amount paid (whether inside or outside the United States) for any transportation of any person by air for both the arrival in and departure from the United States for international travel beginning or ending in the United States. This tax does not apply to any transportation if all of the transportation is taxable under IRC section 4261(a). Before October 1, 1997, the tax was \$6 on departure only. Tax is reported on Form 720, IRS No. 27. See Rev. Rul. 72-107 for further explanation.

Thus, domestic passenger transportation and international passenger transportation are subject to tax. The Taxpayer Relief Act of 1997 made many modifications to the “ticket” tax. The following paragraphs summarize the law before and after this change.

Rate of Tax

Domestic Transportation

The tax on transportation of persons by air is imposed on the amount paid for transportation at the rates shown below.

Date Travel Begins	Rate of Tax
Dec 1, 1990, through Dec. 31, 1995	10%
Jan. 1, 1996, through Aug. 26, 1996	Expired
Aug. 27, 1996, through Dec. 31, 1996	10%
Jan. 1, 1997, through Mar. 6, 1997	Expired
Mar. 7, 1997, through Sept. 30, 1997	10%
Oct. 1, 1997, through Sept. 30, 1998	9%
Oct. 1, 1998, through Sept. 30, 1999	8%
Oct. 1, 1999, and thereafter	7.5%

For travel beginning August 27, 1996, through December 31, 1996, the tax does not apply to amounts paid before August 27, 1996.

For travel beginning March 7, 1997, through September 30, 1997, the tax does not apply to amounts paid before March. 7, 1997.

For travel beginning on or after October 1, 1997, when payment was made before that date, the 10-percent tax rate applies.

Domestic Segment

In addition to the percentage tax, each domestic segment is taxed as follows:

Date of Segments	Tax Rate
Before Oct. 1, 1997	None
After Sept. 30, 1997, and before Oct. 1, 1998	\$1
After Sept. 30, 1998, and before Oct. 1, 1999	\$2
After Sept. 30, 1999, and before Jan. 1, 2000	\$2.25
During 2000	\$2.50
During 2001	\$2.75
During 2003 and thereafter	\$3 multiplied by the cost-of-living adjustment determined under IRC section 1(f)(3)

The segment tax does not apply when payment was made before October 1, 1997.

Definition of Domestic Segment

A domestic segment is any segment consisting of one takeoff and one landing which is taxable transportation described in IRC section 4262 (a)(1) -- (transportation which begins in the United States or the 225-mile zone and ends in the United States or the 225-mile zone).

Changes in Segments

If there is a change in route between two locations on specified flights that changes the number of domestic segments but there is no change in the amount charged for such transportation, the tax is determined without regard to such change in route. Two examples are (1) if the plane is rerouted to another airport because of weather before it arrives at its final destination and (2) if the plane's schedule is changed.

Rate on International Travel

For international flights beginning before October 1, 1997, the tax applies to departures only. On or after October 1, 1997, the tax rate on any amount paid for transportation of any person by air that begins or ends in the United States is \$12 for each arrival and departure, whether the tax is paid inside or outside the United States. The rate will be indexed to inflation for amounts paid after December 31, 1998.

Date Travel Begins	Rate of Tax	Applies to
Dec. 1, 1990, through Dec. 31, 1995	\$6	Departure Only
Jan. 1, 1996, through Aug. 26, 1996	expired	N/A
Aug. 27, 1996, through Dec. 31, 1996	\$6	Departure Only
Jan. 1, 1997, through Mar. 6, 1997	expired	N/A
Mar. 7, 1997, through Sept. 30, 1997	\$6	Departure Only
Oct. 1, 1997, through Dec. 31, 1998	\$12	Arrivals and Departures
Jan. 1, 1999, and thereafter	Indexed to Inflation	Arrivals and Departures

For travel beginning on or after October 1, 1997, the tax applies to amounts paid after August 12, 1997.

Alaska and Hawaii

As under prior law, on flights between the U.S. mainland and Alaska or Hawaii (or between Alaska and Hawaii), there is a tax of \$6 (rather than \$12), and it applies only to departures. The rate is indexed to inflation for amounts paid after January 31, 1998. Thus, for flights before October 1, 1997, the tax is 10 percent of the ticket price attributable to U.S. miles plus \$6. On or after October 1, 1997, the tax is the applicable domestic tax rate times the ticket price attributable to U.S. miles plus \$6 plus the applicable segment tax.

Exception for Segments Beginning or Ending at Rural Airports

In general, if any domestic segment begins or ends at an airport that is a rural airport for the calendar year in which the segment begins, the segment tax does not apply to that segment.

Definition of Rural Airport

The term “rural airport” means any airport if:

1. There were fewer than 100,000 commercial passengers departing by air during the second preceding calendar year from such airport; and

2. Such airport:
 - a. Is not located within 75 miles of another airport which had 100,000 or more commercial passengers departing by air, during the second preceding calendar year, or
 - b. Was receiving essential air service subsidies as of August 5, 1997.

Chief Counsel issues an annual revenue procedure that lists rural airports. For 1997, it was Rev. Proc. 97-46 (as amended by Announcement No. 97-107).

Segments Beginning Before October 1, 1999

The rate of tax applicable to any domestic segment beginning or ending at a rural airport is 7.5 percent.

Multiple Segments

When a flight involves multiple segments of which at least one segment does not begin or end at a rural airport and at least one of which does, the 7.5-percent rate is applied by allocating the amount paid based on the ratio of Great Circle miles in domestic segments involving a rural airport to total Great Circle miles. A Great Circle is an imaginary circle around the globe that divides the globe into two equal parts. The shortest distance between two points on a globe is a segment of a Great Circle.

Example:

Transportation has two segments, one of which begins or ends at a rural airport and one of which does not.

Amount paid on January 1, 1998 = \$400

Number of Great Circle miles in the domestic segment involving a rural airport = 250

Number of total Great Circle miles = 1,200

Rural segment tax = $\$400 \times 250/1200 = \$83.32 \times 7.5\% = \$6.25$

Domestic tax = $\$316.68 \times 9\% = \28.50

Segment tax = 1.00

Total tax = \$ 35.75

Definitions

Taxable Transportation. Transportation by air that begins in the United States or in the portion of Canada or Mexico that is not more than 225 miles from the nearest point in the continental United States and ends in the United States or in the 225-mile zone. (IRC section 4262). Taxable transportation includes layover or waiting time, movement of the aircraft in deadhead service, fees paid for landing, sleeping accommodations, and any hourly charges. (See “Air Charter,” Chapter 7.) If the domestic transportation is paid for outside the United States, it is taxable only if it begins and ends in the United States.

Continental United States. The 48 contiguous states and the District of Columbia; it does not include Alaska or Hawaii.

Uninterrupted International Air Transportation. Any transportation that (1) does not both begin and end in the United States or in the 225-mile zone and (2) does not have a layover time of more than 12 hours. See Rev. Rul. 72-107, where payment was made outside the United States.

Open Jaw Transportation --Treas. Reg. Section 49.4264(e)-1(b)). Round-trip air transportation is generally considered to be two trips. When a round trip includes international travel, the departing and returning flights are considered to be two separate trips. When the return flight arrives at a point other than the original departure point (fly from point A to point B but return to point C) or the return flight departs from a point other than the destination (fly from point A to Point B but return to point A from point C), a determination must be made whether the IRC section 4261(a) tax or the IRC section 4261(c) tax applies.

If the points of the “open jaw” are within the continental United States or the 225-mile zone, the distance between the points of the open jaw cannot exceed the distance of the shorter part traveled to be considered two separate flights. When the open jaw distance within the continental United States is greater than the shortest segment, the trip is considered to be one trip. For example, New York to New Orleans via Panama is considered to be two flights since the open jaw (New York to New Orleans) is smaller than the shorter leg (Panama to New Orleans). The IRC section 4261(a) tax does not apply to the other flight. New York to Miami via Bermuda is considered to be one flight because the open jaw (New York to Miami) is larger than the shorter leg (Bermuda to Miami). Thus, the IRC section 4261(a) tax applies to the trip from New York to Miami.

Payments Subject to Tax -- Treas. Reg. Section 49.4261-7

Examples of methods of payment that are subject to tax unless specifically exempted are listed below.

1. Cash fares: No ticket issued.
2. Scrip books: Tax applies to the amount paid when the scrip book is purchased, not when it is used.
3. Additional charges: Amounts paid for changing the route or destination, extending the time limit of a ticket, changing the class of accommodations, or providing exclusive occupancy of a section, etc. are subject to the tax.
4. Commutation or season tickets: When a single trip is 30 miles or more and the ticket is good for more than 1 month, the cost of the ticket is subject to tax. Tax is collected from the purchaser at the time of payment, not when the tickets are used.
5. Prepaid exchange or similar order for transportation: Tax applies to the amount paid.
6. Chartered conveyances: Amount paid for the charter. (See "Air Charter," Chapter 7.)
7. All-expense tours: Taxable with respect to the portion that represents transportation of persons.
8. Payments remitted to foreign countries by persons in the United States: Payments are considered to be made within the United States, and tax applies.

Other Payments Subject to Tax

Frequent Flyer Miles in General. Amounts paid after September 30, 1997, to an air carrier for the right to provide mileage awards or other reductions in the cost of any transportation of persons are treated as amounts paid for taxable transportation. For example, if a credit card company pays a carrier for the right to award frequent flyer miles to its customers, the payment is taxable.

Mileage Awards Paid by a Controlled Group. Any amount paid by a member of a controlled group after June 11, 1997, and before October 1, 1997, for a right described above, which is furnished by another member of the group after September 30, 1997, is treated as paid after September 30, 1997. See IRC sections 52(a) and (2)

for the definition of a “controlled group.”

Payments Not Subject to Tax -- Treas. Reg. Section 49.4261-8

The following types of payments are not subject to tax or are exempt from tax:

1. Exchange of prepaid order, scrip, etc. for tickets when the tax is paid at the time of payment for the order or scrip; for example, a gift certificate.
2. Caretakers and messengers accompanying freight shipments if no “specific charge” as such is made.
3. Special baggage transportation equipment when it is stated separately.
4. Circus or show conveyances when the amount is paid pursuant to a contract for movement of performers, laborers, animals, equipment, etc. but not for advance agents, bill posters, etc.
5. Tax does not apply to the amount paid for the transportation of a corpse but does apply to the amount paid for the transportation of any person accompanying the corpse. Organs for transplants are taxed as cargo.
6. Miscellaneous charges that include storage or transfer of baggage and parcel-checking. Also, admissions, guides, meals, etc. when such items are included in a lump-sum payment for an all-expense tour. Charges must be stated separately.

Other Payments Not Subject to Tax

Skydiving Flights

IRC section 4261(h) exempts from the tax on transportation of persons, amounts paid for flights that are exclusively for the purpose of skydiving after September 30, 1997. This type of transportation is treated as noncommercial transportation (IRC section 4041(c)), and the fuel used is taxed accordingly.

Exemptions

As a general rule, all users are subject to excise tax on the amount paid for taxable transportation of persons by air. The only exemptions from tax are provided for certain helicopter uses, emergency medical transportation, certain small aircraft, and affiliated groups. (IRC sections 4261(f), 4261(g), 4281, and 4282)

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Chapter 6

Commercial Airlines/Scheduled Flights

Introduction

The major commercial airlines compute the tax for air transportation using a network of computer terminals called a “computer reservations system.” Two such systems used by the airlines are the SABRE system and the APOLLO system. An individual carrier’s sales accounting system merely extracts the passenger’s tax liability from the “auditor’s coupon” lifted from the carrier’s ticket stock (booklet) based on its individual recording procedures. Because airline tickets are usually sold in advance, the revenue recognized does not coincide with the passenger’s tax liability, which is recorded when the ticket is purchased.

Carriers operate under two primary “interline agreements,” which cover interline passenger ticketing, cargo, and baggage procedures. Interline agreements specify the source of accepted published fares and procedures and describe the process of settling funds between participating airlines. Interline agreements are established in order to simplify the ticketing process and minimize the number of tickets necessary to complete an itinerary that involves more than one air carrier.

Settlement between the carriers for revenue earned is either processed (1) through an “interline clearinghouse,” such as the Airline Reporting Corporation (ARC), or (2) directly between the involved parties for providing travel services on tickets sold by other carriers. Currently, airlines do not “interline settle” U.S. taxes. Carriers remit the transportation tax on the basis of their ticket stock sales. If a ticket is used on another airline, that airline bills the selling airline for only the fare, not the air transportation tax.

The liability for air transportation tax is normally recorded by each individual carrier’s accounting system. In addition, some smaller commercial airlines may have contractual agreements with a major airline that allow the smaller airlines to use the major airline’s ticket stock and system to record passenger air fares. The tax liability is lifted or recorded from the major carrier’s ticket stock, which is used to record the smaller carriers’ airfare.

Sources of Information

- Airline annual reports
- Advertising brochures
- Historical examination information

- ARC's Industry Agent's Handbook, which details travel agent ticketing procedures, including refunds and exchanges
- Tour of the airline ticket accounting department
- Federal Aviation Regulations (FAR)
- Trade associations such as the Air Transportation Association of America (ATA) and the International Air Transport Association (IATA)

Examination Techniques

1. Request consolidated workpapers used to prepare Form 720. Reconcile the total passenger transportation tax collected per book to the tax on the Form 720 to verify that all tax collected has been remitted. Explain discrepancies.
2. Reconcile adjustment items on Form 720 to verify that the airline is entitled to the adjustment. Review corresponding accounts for blind credits.
3. Review the general ledger and question the nontaxed revenue accounts to verify that the accounts do not contain taxable passenger revenue.
4. Review liability accounts, paying attention to all sources of tax, especially any unusual debits to the account. Reconcile the liability at the end of the last quarter to ensure that the accrued liability is correct.
5. Review any charter or tour operation of the airline to verify that the tax calculated is correct.
6. Review a sampling of tickets issued under various taxable situations using the ARC Industry Agent's Handbook to verify that the tax was calculated correctly per ticket. (Request a current copy of the handbook from the airline.)
 - a. Verify that exemptions were not granted to state and local governments, the United States and its possessions, diplomats, or nonprofit educational organizations.
 - b. Sample revenue accounts by analyzing lifted tickets, refunds, exchanges, upgrades, etc. to verify that the applicable excise tax has been collected.
7. Airlines may pay tax based on historical records with a corresponding reversal the next month. Verify that the correct reversal has been made and determine that the estimates used are historically accurate.

8. Review all refund claims (Form 8849, or Form 843, Claim for Refund and Request for Abatement; and Form 4136). Request supporting workpapers and verify that each claim is allowable.

Possible Issues

1. Adjustments under Part III of the Form 720 may contain credits for excise tax that was not refunded to the customer per IRC section 6415.
2. Passenger tickets may not include all taxable items for computing the excise tax; in other words, certain charges may have been excluded from the tax base.
3. Barter transactions with sports organizations, etc. may be structured so that no tax is collected.
4. Amounts paid by credit card companies, banks, etc. for the right to award free or reduced-price air transportation (frequent flyer miles) are subject to excise tax.
5. Excise tax may not have been charged on Government or military contracts.
6. Ticket upgrades or exchanges may not include the additional tax.

Citations

-- Rev. Rul. 55-534	Payment Two or More Carriers
-- Rev. Rul. 55-762	Time Payment Plan
-- Rev. Rul. 57-545	Non-Transportation Items
-- Rev. Rul. 73-344	State Taxes Included in Tax Base
-- Rev. Rul. 70-381	Nominal Charge to Employees
-- Rev. Rul. 70-515	Travel Cards
-- Rev. Rul. 73-508	Security Charge In Ticket Cost
-- Rev. Rul. 74-123	Government Agency
-- Rev. Rul. 76-550	Municipal Associations
-- Rev. Rul. 80-31	Service Charge (revoked Rev. Rul. 77-392)
-- Rev. Rul. 84-12	Free Bonus Tickets
-- Rev. Rul. 89-109	Refunded Tickets

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Chapter 7 Air Charter

Introduction

IRC section 4261(a) imposes a tax on amounts paid for taxable transportation of persons by air. In the examination of air charters, the amounts paid for taxable transportation include the actual amount paid for the flight plus any payments made for related services. Such payments include meals, waiting time, deadhead time (empty plane returning to base), crew expenses, sales taxes, landing fees, parking, and other amounts related to the flight. Other includible charges are listed below.

- **Rev. Rul. 72-565.** Amounts paid for charges in connection with layover time of charter aircraft consisting of an hourly rate plus expenses of the pilot and crew are subject to the air transportation tax.
- **Rev. Rul. 73-344.** State sales tax imposed on sellers of air transportation and passed on to their customers as a separately billed item is part of the amount paid and is includible in the amount on which the tax is imposed.
- **Rev. Rul. 74-123.** Amounts paid by a federal agency for transportation of its employees to an air charter company for flights on both Government-owned and company planes are taxable under IRC section 4261.

Leases

To determine if lease payments are subject to the air transportation tax, the most important factor to consider is whether the owner of the aircraft transfers possession, command, and control of the aircraft. The following citations address the issue of leases:

- **Rev. Rul. 57-545.** Amounts paid by a company for the lease of an aircraft, including operation and maintenance expenses, for transporting the company's personnel are subject to the tax imposed by IRC section 4261.
- **Rev. Rul. 58-215.** A corporation that owns an aircraft and appoints an airline company to service, maintain, and operate the aircraft for the purpose of transporting the corporation's personnel is not being furnished transportation by the airline company and is not subject to the IRC section 4261 tax.

- **Rev. Rul. 60-311.** An owner of an aircraft is furnishing taxable transportation if the owner
 1. Leases the aircraft with pilots to others for transportation of persons by air;
 2. Retains elements of possession, command, and control of the aircraft; and
 3. Performs all services in connection with the operation of the aircraft.

Wet Lease vs. Dry Lease

Under a wet lease, the lessor includes crew and other services as part of the lease arrangement. These amounts are subject to the air transportation tax because control of the aircraft remains with the lessor company and the lessor's crew is responsible for the operation of the aircraft.

Under a dry lease, the lessee furnishes its own crew and pilot and pays a set amount for the lease. Control of the aircraft is transferred to the lessee. Accordingly, the payment is for rental of the aircraft, not for taxable transportation.

Sources of Information

Several sources of information can be used to select taxpayers for examinations:

- **Abstract Listings.** Check for taxpayers filing under IRS Nos. 26, 27, and 28. This will allow you to examine taxpayers who have filed and may lead you to other examinations.
- **Governmental Agencies.** The FAA and state agencies have information on registered aircraft that can be compared with abstract filings.
- **Airport Registers.** While examining a taxpayer at an airport, check the register for a list of charter companies using the airport or request a list of tenants from airport management.
- **Invoices.** While conducting the examination of your taxpayer, check invoices to see if other charters have flown your taxpayer's customers. You can then select the other charter company for examination and cross-check to see if the tax was paid.
- **Advertisements.** Check local telephone books, newspaper advertisements, travel guides, and resort brochures for listings of charter companies.

Examination Techniques

There is a different approach to conducting the examination of a small air charter company. You must first review the operation of the company with an employee or officer to determine the type of services provided, the types of aircraft flown, the area covered, the types of records kept, the services the taxpayer considers taxable, the method by which the tax is computed, and any other information that can be obtained about the business.

Secure a list of aircraft owned or leased by the company and determine by registration number the certificated take-off weight of each aircraft.

Review the flight logs and corresponding invoices looking for untaxed flights and details of untaxed items. Verify that all taxable items are properly accounted for.

Ask for any lease agreements to determine if there are any issues involving wet vs. dry leases.

Review the Form 1120, the Form 4136, and any fuel usage reports. Also review sales and accounts receivable for any unusual entries.

Some of the common issues you will encounter are items improperly excluded from the tax calculation, flights being excluded for improper exemptions, and improper treatment of wet leases.

Small Aircraft on Nonestablished Lines

IRC section 4281 exempts transportation on aircraft having a maximum certificated takeoff weight of 6,000 pounds or less from the air transportation tax except when they operate on an established line.

An established line is an aircraft operated with some regularity between definite points. See Treas. Reg. section 49.4263-5(c).

When both charter and regularly scheduled flights are operated by a carrier between two points, both are considered taxable flights. (Rev. Rul. 72-219, 1972-1 C.B. 350)

Helicopters

Under IRC section 4261(e), air transportation by helicopter is exempt from tax for:

- Transportation of individuals, equipment, or supplies in the exploration, development, or removal of hard minerals;

- Planting, cultivating, cutting, transportation, or caring of trees, including logging operations; and
- Transportation of individuals, equipment, or supplies in the exploration of oil or gas.

For this exemption to apply, the helicopter must not take off from, land at, or use any services of an airport receiving assistance under the Airport and Airway Development Act of 1970.

Emergency Medical Flights

IRC section 4261(f) exempts helicopters and fixed-wing aircraft providing emergency medical services from the air transportation tax. These aircraft must be equipped for and exclusively dedicated to emergency medical services. The Taxpayer Relief Act of 1997 clarified this exemption by specifying that it is to be determined on a flight-by-flight basis.

Under **Rev. Rul. 75-535**, amounts paid for air flight and standby time in connection with unscheduled air ambulance service furnished by a nonprofit organization are subject to the tax on air transportation.

Under **Rev. Rul. 77-75**, amounts paid for separately billed, in-flight medical costs are not subject to the air transportation tax.

Chapter 8

Corporate Flight Departments

Introduction

Many corporations own or lease aircraft that are used for business purposes. Corporations may also become involved in different types of ownership agreements that may result in taxable air transportation to the corporate owners.

Affiliated Groups

IRC section 4282 exempts amounts paid by one member of an affiliated group to another member from the air transportation tax. “Affiliated Group” is defined in IRC section 4282(c) and refers to IRC section 1504(a). If a third party outside the affiliated group uses the aircraft, the amount paid for air transportation is taxable under IRC section 4261. Prior to August 27, 1996, this exemption was determined on a plane-by-plane basis. Thus, if only one flight violated the affiliated group rule, all flights during that quarter were taxed. On August 27, 1996, the Small Business Job Protection Act of 1996 revised IRC section 4262 so that the exemption is now determined on a flight-by-flight basis.

Definitions of Commercial Aviation

The FAA defines “commercial aviation” as the carriage of persons or property by air for profit. Compare this to the IRS definition, which simply requires that the carriage be undertaken for compensation. The differing definitions can cause confusion among aircraft operators. Flight departments often assume that, since a flight is not considered commercial for FAA purposes, that flight is not considered commercial for any other purpose. However, the Service is not bound by other agencies’ definitions of commercial and noncommercial aviation. Rev. Rul. 78-75, 1978-1 C.B. 340 states that the status of an aircraft operator as a “commercial operator” under FAA regulations does not determine the commercial or noncommercial status of the operator in the application of the aviation fuel and air transportation taxes.

The Federal Aviation Regulations (FAR) allow Part 91 noncommercial operators to engage in certain arrangements that would ordinarily be viewed as commercial without jeopardizing their Part 91 certificates. These arrangements are interchange agreements, time-sharing agreements, demonstration flights, and the carriage of elected officials.

Interchange Agreements

An interchange agreement allows two or more unrelated corporations that own aircraft to use the others' aircraft on an as-needed basis. Each corporation bears the costs and expenses of operating its own aircraft. Out-of-pocket expenses not directly related to the operation of the aircraft are borne by the corporation using the aircraft. The agreement works on a barter system, with each corporation earning credit for flight time.

Although interchange agreements are permitted under FAR Part 91, they constitute taxable air transportation under IRC section 4261.

The tax is computed on the fair market value of the hourly flight time for each aircraft used in the agreement.

An Information Document Request should be issued to the taxpayer asking if he or she is involved in any interchange agreements. A review of the flight logs will also disclose whether anyone outside the corporation is using the aircraft. Outside use might indicate an interchange agreement. If the corporation is involved in an interchange agreement, the other corporations in the agreement should also be examined for taxable transportation issues.

A corporation that has entered into an interchange agreement is providing taxable transportation under IRC section 4261. See *Executive Jet Aviation v. United States* 80 A.F.T.R.2d, para 97-5352 (Fed Cir 1997).

Time-Sharing Agreements

A time-sharing agreement is an arrangement whereby a person leases his or her airplane with a flight crew to another person. No charge is made for the flights conducted under such arrangements other than for

1. Fuel, oil, lubricants, and other additives;
2. Travel expenses of the crew, including food, lodging, and ground transportation;
3. Hanger and tie down costs away from the aircraft's base of operation;
4. Insurance obtained for the specific flights;
5. Landing fees, airport taxes and similar expenses;

6. Customs, foreign permits, and similar fees directly related to the flight;
7. In-flight food and beverages;
8. Passenger ground transportation;
9. Flight planning and weather control; and
10. An additional charge equal to 100 percent of the fuel, oil, lubricants, and other additives.

Although a time-sharing agreement is not considered commercial for FAA purposes, it is taxable. The company that owns the aircraft is receiving payment for air transportation and is liable for the tax under IRC section 4261.

Demonstration Flights

A demonstration flight takes place when a potential customer rides in an aircraft in contemplation of the purchase of the aircraft.

If the seller of the aircraft uses the aircraft for sale and receives no payment from the purchaser, there is no taxable transportation.

If the seller receives payment from the purchaser, then payment has been made for taxable transportation, and the tax must be collected.

If the seller uses a plane that is leased but provides the crew and pays for operation and maintenance of the aircraft, there is no taxable transportation.

If the seller leases an aircraft and the crew and all expenses are supplied by the lessor, then the lease payment is considered payment for taxable transportation. See Rev. Rul. 68-256.

Elected Officials and Candidates

A candidate is an individual who seeks election to a federal office and who has received contributions aggregating in excess of \$5,000 or has made expenditures aggregating in excess of \$5,000.

When a political official or candidate uses a corporate aircraft, it is taxable air transportation under IRC section 4261.

If the city traveled to is served by regularly scheduled commercial service, the value of the flight is equal to first class airfare. When the city traveled to is not served by regularly scheduled commercial flights, the value of the flight is equal to the regular charter rate. In all cases, the payment must be made prior to the flight. Otherwise, it is a violation of Federal Election Law.

Corporate Officers and Employees

When a corporation's aircraft is available to employees and officers for personal use, there may be taxable air transportation.

If the employee or officer had the value of the flight(s) included in his or her income as other compensation, there is no taxable transportation since no payment was made.

If the employee or officer reimburses the company for the value of the flight, a payment for air transportation has been made and is subject to the tax.

An Information Document Request should be issued to the corporation to request the corporate policy regarding personal use of the corporate aircraft and information on how it is accounted for.

Aircraft for the Exclusive Use of Shareholders

Often, a group of individuals organize a corporation to acquire, operate, and maintain an aircraft for use exclusively by such individuals in their business and personal interests. A full-time pilot is employed by the corporation to fly the aircraft. With respect to any given flight, the shareholder using the aircraft establishes the schedule and destination, but the pilot has authority for the safety and operation of the aircraft.

Each shareholder is charged an amount for flight service based either on an hourly rate or on the number of miles flown. These rates are calculated to cover all costs of operation.

The corporation owns and maintains the aircraft and employs the full-time pilot. It retains possession, command, and control even though the users establish the schedule and destination of the flight.

The corporation is engaged in selling taxable air transportation, and the tax under IRC section 4261(a) applies.

Joint Ownership

Due to the high cost of ownership and maintenance of aircraft, taxpayers often purchase an aircraft together with an unrelated party. The joint owners share the fixed costs and pay for their own direct operating expenses. In general, registered owners who pay their pro rata share of the fixed costs and their own direct operating costs are treated as using their own aircraft; thus, their flights are not subject to air transportation taxes.

Fractional Ownership

In a fractional ownership arrangement, the registered joint owners of an aircraft enter into a contract with a management company. The management company manages the aircraft and puts it in a pool with other aircraft. The management company hires the pilots and pays their salaries.

When the aircraft in which the owner has an interest is not available for the owner's use at a particular time, the management company provides another aircraft from the pool of aircraft. If no aircraft from the pool is available, the management company provides an aircraft from its own fleet.

The issue of whether the owners have surrendered possession, command, and control of the aircraft to the management company must be addressed. The nature of the rights surrendered must be weighed against the nature of the rights retained in order to determine whether the management company is providing taxable transportation.

See *Executive Jet Aviation Inc. v. United States* (1997, CA Fed Cir) 80 A.F.T.R.2d 96-5093 (80 A.F.T.R.2d Para 97-5352).

Management Companies

A management company enters into an agreement with a corporation to operate and maintain its aircraft and provide the pilots, fuel, and insurance for the aircraft. The corporation pays for all costs attributable to the operation of the aircraft for its use, including the salaries and standby charges for the pilots and all expenses for fuel, insurance, and overnight fees. The corporation has the right to replace any of the certified pilots and to direct them when and where to fly.

Since the corporation owns the aircraft, has exclusive control over the aircraft's personnel, pays the operating expenses of the aircraft, and maintains liability and risk insurance, the management company that operates the aircraft is acting as an agent of the corporation and is not required to collect the air transportation tax on payments it receives from the corporation for flights it provides for corporate personnel. See Rev.

Ruls. 58-215 and 60-311.

Sources of Information

Several sources of information can be used to select taxpayers for examination:

- **Revenue Agent Referrals.** The main source of leads for corporate aircraft issues are referrals from the agents doing the income tax examination. A way to generate referrals is to attend continuing professional education and group meetings of income tax agents to ensure they are aware of potential issues involving corporate aircraft.
- **Governmental Agencies.** The FAA and state agencies have listings of aircraft registered to corporations.
- **Airports.** Management has a list of corporations that use the airport for hanger space or maintenance.
- **Examination of Taxpayers.** When a taxpayer who is involved in any agreement that involves other corporations is being examined, the other corporations should also be examined for potential issues.

Examination Techniques

When examining a corporation for air transportation issues, it is essential to examine the flight logs of the aircraft. The flight logs contain information necessary to make a determination on the taxability of flights. Information that flight logs contain includes

1. The name of the individual who is requesting and authorizing the use of the aircraft and the purpose for which it is being used;
2. Names of the crew members on the flight;
3. Departure and arrival times and dates of all destinations of the flight;
4. A list of all passengers on each leg of the flight; and
5. Expenses of the crew for any layovers involved in the flight.

Flight logs may also indicate whether the flight was for someone other than the company that owns the aircraft.

The flight logs should also be compared with any records the corporation maintains for accounting or payroll purposes. The corporate policy on personal use should be obtained and checked against the payroll and accounting records.

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Chapter 9

Tour Operators and Travel Agencies

Introduction

One of the more interesting yet commonly misunderstood areas of air transportation deals with the applicability of the Federal Excise Tax to the tour and travel industry.

The purpose of this section is to provide the examiner with general and technical background information to make excise tax examinations of tour operators and travel agencies more efficient and effective. It details various types of tour operations, describes the relationship between the operator and the travel agent, and provides guidance on determining which party is responsible for the collection and remittance of the tax to the Government.

Areas of Consideration

Areas of consideration are listed below.

- Tour operators
- Airlines/air carriers
- Air transportation vs. non-air transportation charges
- Foreign-booked tours
- Established lines
- Travel agencies
- Tour brokers
- Agent vs. principal relationship
- Audit techniques and guidelines
- IRC section 6672 Penalty

Background

In general, the tour operator is an entity that packages or markets inclusive tours and sells them either through travel agents or directly to the public. Tour operators deliver the services specified in a given, advertised package. They may provide these services themselves (some tour operators own planes, buses, hotels, or other facilities), or they may obtain them from suppliers, such as specific hotels, airlines, or car rental companies. In some cases, their offerings are marketed directly to the general public; in other cases, they are designed to the specifications of a wholesale travel agency that sells them under the agency's name. A tour operator profits from selling its package for amounts greater than its cost.

Tour operators referred to as “ground operators” normally provide services at the destination only; they do not package or market transportation to or from the destination. The services provided by such operators -- normally overnight accommodations, sightseeing and transfers -- are usually collectively referred to as “land arrangements.” In this context, the term “tour operator” refers to the airline or air carrier that is actually providing air travel to its customers. Travel agencies are also customers of the tour operators since they purchase tour packages for resale to the general public. It is important to remember that the person paying for taxable air transportation is liable for the transportation tax, but the person receiving the payment must collect the tax and file the return. Refer to IRC section 4291.

A travel agency arranges for travel services from suppliers such as airlines, hotels, car rental companies, and cruise lines. Typically, travel agencies operate at the retail level, the wholesale level, or both.

Retail agencies sell services directly to the consumer; it may be helpful to view them as commissioned middlemen for numerous suppliers of travel services. Most agencies provide information and reservations services at no charge to the customer; but in some locales, retail agencies are considering a fee structure for these services. The “consumer” is often thought of as an individual seeking transportation services or a tour booking. For many agencies, however, the more important “consumer” may be the business accounts. The income reported on the agency’s tax return does not indicate the relative importance of the business accounts, but to the excise tax examiner, it provides valuable information about the point of collection of excise tax.

A wholesale agency primarily assembles and sells “packages” of services, such as air and land arrangements to Alaska or Hawaii. Although some wholesale agencies specialize in only one type of service, such as air passage to South America, they do not usually provide these services themselves; rather, they secure them from suppliers. The consumer is the individual traveler, and the traveler must normally purchase the package through a retail agency. A wholesale agency earns its income by securing blocks of reservations and reselling them at a markup. Suppliers deal with wholesalers instead of selling only to the public directly because wholesalers generate advance sales to the suppliers.

Relationship Between the Entities

The functions of the above-described entities are not sharply separate or mutually exclusive. Although some entities operate strictly as retail agencies or as wholesalers, it is not unusual to find other who have both features of both within their operations. Along with selling a full range of retail services, some agencies wholesale unusual vacation packages they have assembled. In such cases, an individual who wants to

book one of those vacation packages has to make the booking through a travel agency.

Accordingly, a tour operator can also function as a wholesaler. An example is a company that offers bus tours of selected areas of the United States. Its primary operation is conducting tours. For some portions of those tours, it uses its own facilities; for other portions, it enters into contracts with suppliers for other portions. In this capacity, it is a tour operator. It is also a wholesaler to the extent that it markets its tours through retail agencies.

As we further discuss the responsibility for the collection and remittance of the Federal Excise Tax, the distinctions among these entities will become more critical.

Operations

The large majority of tour operators are smaller air carriers and airlines who are categorized by the FAA as Part 135 carriers (on-demand air taxi services). These operators assemble tour packages that combine air transportation as well as non-air transportation components. The total package includes the air flight, lodging and meals (if applicable), ground transportation, baggage handling, and any fees, options, and services that are charged to the customers.

When selling the tour packages directly to the paying public, the tour operator has the responsibility for the collection and remittance of the excise tax. It is incumbent on the operator to maintain adequate records in order to determine the basis on which to apply the tax. In other words, a distinction is required to split the air transportation component (actual taxable flight and related services) from the nontaxable, non-air transportation components. Such nontaxable items are:

- Ground transportation;
- Baggage handling, storage, and transfer; and
- Charges for admissions, guides, meals, hotel accommodations, and other nontransportation services.

Refer to Treas. Reg. sections 49.4261-7 and -8 for examples of payments subject to, and payments not subject to the tax. However, Treas. Reg. section 49.4261-2(c) provides:

If the charges for nontransportation services are not separable and are not shown in the exact amounts thereof in the records pertaining to the charges for transportation of the person, the tax must be computed upon the full amount of the payment.

The examiner should review records for changes to ensure that values assigned to nontaxable transportation are not higher than their actual value. If such values are too high, they have the effect of minimizing the base on which the excise tax is computed. For example, when a total tour package price is \$100, a taxpayer may insist that the nontransportation charges are \$75. This then results in a excise taxable base of \$25. Ask the taxpayer to provide adequate substantiation and valuations for the charges, and review them carefully. Refer to *Cross v. United States*, 63-1 U.S.T.C. 15,466; and *White House Sightseeing Corp. v. United States*, 62-1 U.S.T.C. 15,395.

When a tour operator/air carrier sells tour packages or junkets to the public, the tour price is a set figure with no breakdown for air transportation and non-air transportation charges. One flat fee that purportedly covers all charges is charged. In *Las Vegas Hacienda, Inc. v. Civil Aeronautics Board*, 298 F.2d 430 (1962), it was held that a resort hotel operator selling package tours from a city in another state, including “free” airplane rides on its aircraft, was a common carrier for compensation or hire. This holding was followed in Rev. Rul. 63-155, 1963-2 C.B. 566, which states that the amounts paid by hotel customers for the package tours included a charge for taxable transportation; thus, the portion of the amounts paid for the tours that is reasonably attributable to the transportation service is subject to the transportation tax. The revenue ruling outlines the formula used to arrive at the tax base on which the excise tax is calculated.

Further, Rev. Rul. 72-585, 1972-2 C.B. 578 states that, if a single amount is paid for air transportation of a mixed load of persons and property, tax must be paid (1) under IRC section 4261 on the part of the payment that represents the amount charged for transportation of persons and (2) under IRC section 4271 for the payment representing transportation of property. An allocation of the single charge must be made on a fair and reasonable basis and must be supportable by adequate records.

A number of tour operators/airlines deal with foreign-based travel agencies that sell package tours to vacation destinations in the United States. As part of the total package, a “sightseeing trip” by air to a national park or other attraction is included. The domestic tour operators have not collected the excise tax on this segment of the flight, citing that the total flight is uninterrupted international air travel that begins and ends outside the United States. Be aware that these are situations in which attention must be directed to the facts and circumstances in order to determine whether the sightseeing destinations are merely “side trips.” Some entities even go so far as to use the larger airlines’ ticket stock to show the sightseeing location as the ultimate destination.

A common mistake made by tour operators who use their own airplanes to fly tour passengers is that they claim to be exempt from the excise tax because they operate small aircraft under 6,000 pounds. This misconception stems from their interpretation

of the Federal Aviation Administration Regulations, Part 135, which categorizes these small aircraft as “on demand air taxi services, not operated on a specific SCHEDULE.” However, most do maintain somewhat of a schedule since they want to maximize the aircraft usage. These operators normally run morning and afternoon trips and set approximate times for departures. The issue in these cases is whether the carriers operate on an established line. The determination of whether an aircraft is operating on an established line is based on the facts and circumstances, using such criteria as regularity and frequency of flights. IRC section 4281, together with the accompanying regulations, and Rev. Rul. 78-75, 1978-1, C.B. 340 provide information and guidance in these cases. Also refer to Rev. Rul. 72-219, 1972-1, C.B. 350.

When a tour operator/airline sells the air flight portion of a tour package to a travel agency/tour broker, a determination is necessary to establish who is paying an amount for taxable transportation, the travel agency or the passenger. For instance, when a tour agency sells a package tour and collects from the customers then pays the aircraft operator for the air transportation segment, the aircraft operator is receiving a payment for taxable transportation, and it must collect the tax on that payment, regardless of whether the payment is made by the tour agency/broker or a passenger. (Treas. Reg. sections 49.4261-7(h)(1) and (2))

Although it is clear from Treas. Reg. section 49.4261(h) that a person who charters an aircraft and then charges others for transportation on that aircraft must collect the tax from those others, there are other fact patterns, such as when a broker buys a block of seats on the aircraft but does not lease the aircraft. The facts in each case must be analyzed to determine who is purchasing taxable transportation.

Rev. Rul.75-296, 1975-2 C.B. 440 further elaborates on the distinction between agent and principal. When selling taxable transportation, a travel agency is acting either as a principal or as an agent for the airline company. When independent travel agencies sell tours to be taken on aircraft chartered from a carrier, the travel agencies are acting as principals and are required to collect the transportation tax, file returns, and pay the tax to the Government. However, when travel agencies sell taxable tours as representatives of the airlines, they are acting as agents of the airlines. As agents, they are required to collect the transportation tax and remit the tax to the airlines. The airlines, in turn, are required to file returns and pay the tax to the Government. This agency-versus-independent-broker distinction is based on a number of factors such as the exercise of possession, command, and control over the aircraft.

Examination Techniques

The most valuable and complete information you gather comes from an interview with the taxpayer. A tour of the taxpayer’s facility to see how daily business is conducted

is the best way to learn.

Reviewing and inspecting the taxpayer's in-house books and records provides only a portion of the data needed for an audit. Pilots' log books, flight charts, and information required by the local airport authority (such as passenger counts) are extremely informative. Airport Authorities, which are also required to provide information to the FAA and the U.S. Department of Transportation, are also good sources of data.

In addition to the sales, income, and expense information you can obtain from the taxpayer's books, a review of the following data and documentation discussed below is necessary.

You must first review the operation of the company to determine the types of services furnished, the types of aircraft used, the areas covered, the records kept, the services the taxpayer considers taxable and not taxable, the method by which the tax is computed, and other information deemed appropriate.

Review the records looking for untaxed revenue, including records on untaxed flights as well as the details of items not taxed on charter flights. Make certain that the untaxed charges are, in fact, properly described.

The air carrier prepares a list of passengers on each flight in case of an accident. Request these manifests to compare the number of passengers flown with the number of passengers reported for the excise tax computation.

Pilots keep a log for each flight.

Review a copy of the charter or lease agreement(s) when applicable. Such documents often spell out the arrangements for the collection and payment of taxes.

Whenever possible, secure brochures and pamphlets from the taxpayer's flight terminal/ facility.

Contact the travel agencies that air carriers use as sources of customers. Also, see if the air carrier uses any large commercial bus services as a source of customers.

Since many air carriers use vouchers in lieu of tickets, secure the vouchers to determine the passenger counts.

Determine the basis on which the excise tax was collected from the passengers. Some air carriers and travel agents have charged the air transportation tax on the total tour package price.

Contact the local airport authority to get the figures on the passenger facility charge if applicable.

Review the aircraft maintenance logs to determine the flight hours and the frequency of trips.

Trust Fund Recovery Penalty

IRC section 4291 states that, “Except as otherwise provided in section 4263(a), every person receiving any payment * * * on which a tax is imposed * * * shall collect the amount of the tax from the person making such payment.”

The air transportation excise tax is a collected tax that is payable by the person paying for the taxable air transportation. As such, when the examiner determines that an excise tax liability exists but the party responsible for the collection and remittance of the tax has not done so, the provisions of IRC section 6672 must be considered.

IRC section 6672(a) states that, “Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. * * *”

A careful examination of the facts and circumstances must be made in each case to determine the applicability of this Code section.

Refer to Rev. Rul. 54-158, 1954-1 C.B. 247; *Industrial Communications Systems v. United States*, US DC 70-1 U.S.T.C. 15,942; *Cross v. United States*, 63-1 U.S.T.C. 15,466; *White House Sightseeing Corp. v. United States*, 62-1 U.S.T.C. 15,395; *Air Tour Acquisition Corp. d.b.a. Panorama Air Tour v. United States*, DC 92-1 U.S.T.C. 50,189.

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Chapter 10

Air Transportation of Property

Introduction

IRC section 4271 imposes a tax on amounts paid for taxable transportation of property by air, but only if they are paid to a person engaged in the business of transporting property by air for the person. (Profit is *not* a motive).

IRC section 4271 imposes a 6.25 percent tax on property being transported within the United States and its boundaries. The tax applies to amounts paid to an air carrier by a freight forwarder or express company for the transportation of property by air.

The amount paid includes actual amounts paid for the flights plus any payments made for crew expenses such as pilot meals, lodging, waiting time, deadhead time (empty plane returning to base), sales taxes, landing fees, parking, and any other amounts related to the charter flight.

The user tax on air transportation of property imposed by IRC section 4271 applies to all users. It is reported on Form 720, and deposit requirements apply.

Liability for Tax

IRC section 4271(a) provides that the tax applies only to amounts paid to persons engaged in the business of transporting property by air for compensation.

The term “property” does not include excess baggage accompanying a passenger traveling on an aircraft operated on an established line.

The term “transportation” includes layover or waiting time and movement of the aircraft in deadhead service.

The term “taxable transportation” is defined in IRC section 4272 as transportation by air that begins and ends in the United States.

If the payment is made outside the United States and no tax is collected, then the person to whom the property was delivered is liable for the tax.

The tax does not apply to amounts paid for transportation partially or entirely by air that (1) begins in the United States and ends outside the United States or (2) begins outside the United States and ends in the United States.

The domestic portion of an international cargo flight is not taxable.

For payments made outside the United States, collection of the tax is to be done by the person furnishing the last segment of the air transportation.

The tax on transportation of property by air does not apply to amounts charged for the non-U.S. portion of a flight from the continental United States to Alaska on either a nonstop flight or a flight with a scheduled stopover in Canada beyond the 225-mile zone. However, if the flight includes a scheduled stopover within the 225-mile zone, only the portion of the flight from the stopover point to the Alaskan border can be excluded from the application of the tax. (Rev. Rul. 75-27)

Exemptions

The exemptions applicable to other excise taxes, such as communications taxes, do not apply to the taxes on transportation of property by air.

The 6.25 percent air cargo tax does not apply to amounts paid for the transportation of property by air if the transportation is furnished on an aircraft having a maximum certificated takeoff weight of 6,000 pounds or less, unless the aircraft is operated on an established line. See IRC section 4281.

The affiliated group exemption under IRC section 4282 also applies to the transportation of property by air. See the discussion under "Transportation of Persons."

Computation of Property Tax

Excise tax is imposed only on the amount paid to a person engaged in the business of transporting property by air for compensation as defined in IRC section 4272.

Amounts paid for accessorial services for transported property provided by the air carrier (either directly or through an independent contractor) are taxable if (1) such services can be provided only by the airline directly or indirectly, and (2) the charge for the service is applicable to all those using it. For example, if the service can be provided by a freight forwarder, the amounts paid for the service performed by the air carrier are not considered amounts paid for the transportation of property by air, but only if the charges for such services are separately stated.

Some accessorial service charges are for:

-- Collections made C.O.D.,

- Terminal handling service,
- Packing a shipment, and
- Stopping in transit.

Terminal handling and shipment packing accessorial services performed by the air carrier are services that, by their nature, could be performed by a party other than the air carrier. It is held that amounts paid for these services are not subject to the tax imposed by IRC section 4271 if stated separately. (Rev. Rul. 71-398, 1971-2 C.B. 373)

Stopping in transit accessorial service is directly related to the transportation; it is a service that can be provided only by the carrier rendering the transportation service. Amounts paid for this service are subject to the tax imposed by IRC section 4271.

The rates for air transportation of property per IRC section 4271(c) are listed below.

For transportation beginning:

- December 1, 1990, through December 31, 1995 = 6.25 percent
- January 1, 1996, through August 26, 1996 = expired
- August 27, 1996, through December 31, 1996 = 6.25 percent
- January 1, 1997, through March 6, 1997 = expired
- March 7, 1997, and thereafter = 6.25 percent

For transportation beginning between August 27, 1996, and December 31, 1996, the tax does not apply to payments before August 27, 1996.

For transportation beginning on or after March 7, 1997, the tax does not apply to payments made before March 7, 1997, unless one member of a controlled group made the payment to another.

Examination Techniques

Examination techniques are listed below.

1. In examinations of large companies, note that most are publicly held and issue annual reports to their stockholders. Reviewing these reports for 1 or more years will give important information about the taxpayers.
2. Another source of information on large companies is the Securities and Exchange Commission Form 10K (annual report and related documentation) if the form is required to be filed. Large companies may produce their own newsletters, which are valuable tools for learning about changes in company functions and everyday

business practices. Large companies may also produce trade magazines or other publications.

3. Interview not only tax managers but also individuals who deal with the daily operations of the aircraft, such as chief pilots, maintenance personnel, and scheduling agents when appropriate. In Coordinated Examination cases, who you can interview may be limited. Be aware of the disclosure rules.
4. Reconcile total property transportation tax collected per book to the tax on the Form 720 to verify that all tax collected has been remitted. Explain discrepancies.
5. Reconcile adjustment items on the Form 720 to verify that the airline is entitled to the adjustment. Review corresponding accounts for blind credits.
6. Review the general ledger and question the nontaxed revenue accounts to verify that the accounts do not contain taxable property revenue.
7. Review liability accounts, paying attention to all sources of tax, especially any unusual debits to the account. Reconcile the liability at the end of the last quarter to ensure that the accrued liability is correct.
8. Airlines may pay tax based on historical records with a corresponding reversal the next month. Verify that the correct reversal is made and determine that the estimates used are historically accurate.
9. Make sure the companies are using only one method of taxation during the quarter, either the collected tax method or the alternative method or “billing method.” See Treas. Reg. sections 40.6302(c)-1 and 40.6302(c)-3.
10. Exemptions usually allowed to various organizations or governmental agencies are not allowed for this tax, which is considered a user charge. Verify that exemptions were not granted to state or local governments, the United States and its possessions, diplomats, nonprofit educational organizations, or human organ transplant teams.
11. Review all refund claims filed on Form 8849, Form 843, and Form 4136. Request supporting workpapers and verify that each claim is allowable.
12. An integrated company (having both air and ground business) must calculate the tax by allocating revenue between ground and air. Ensure that the carrier allocates correctly its nontaxable ground cost to taxable air cost. Erroneous allocations may

cause an understatement or overstatement of tax. (An overstatement of tax cannot be refunded to the carrier unless the carrier has refunded the amount to the customer or has obtained the customer's permission to claim the refund. See IRC section 6415.)

The methodology consists of complicated cost accounting systems that require detailed examinations of cost centers to determine whether the formulas are consistent with a proper allocation of the costs. To examine such business practice, considerable knowledge of the company's business practice is necessary. Flowcharts, charts of accounts, access to computer files, and an experienced computer audit specialist are a must on such exams.

Direct air cost, direct ground cost, and supplemental or other costs must be correctly allocated to derive the correct amount of tax. When there are both air/ground or supplemental costs are incorporated in dedicated expenses, a study must normally be made of these cost centers if the integrated company has not made allocations in the original computation.

An area that requires scrutiny is the allocation of costs for sorting facilities known in the business as "package sorting facilities" or "super hubs." Another term used in the business is "terminal handling." On the books, it is known as "terminal handling charges." Such charges, which represent substantial costs to these companies, have a substantial effect on the allocation.

It is important to review Rev. Rul. 80-53, 1980-1 C.B. 252 on the terminal handling charge issue. Underlying this revenue ruling is a conclusion by the Department of Justice that the charges paid by the Postal Service were accessorial nontaxable charges because, under the facts in the particular case, it was held that (1) the charges were not for services that could be provided by the air carrier and (2) the charges were separately stated.

Many integrated companies are claiming that their terminal handling services or package sorting facilities are identical to those in the Postal Service case. Such cases must be determined on the basis of each company's facts and circumstances and must meet the two requirements raised in Rev. Rul. 80-53.

All supplemental air/ground costs must be excluded from the ratio to arrive at a correct excise tax rate. Some examples of these supplemental costs are international cost, cost of sales, administrative expenses, corporate expenses, and computer cost. Pay close attention to international cost since these expenses may be substantial and can easily be lost in ground cost.

13. Remember that only the ultimate purchaser of aviation fuel is entitled to the refund or credit if cargo taxes are collected and paid over to the Government.
14. Larger cargo companies have a direct pipeline to the airports at which they purchase bulk fuel tax-free or at a tax-reduced rate using Form 637. Be sure these purchases are not included with any credits claimed for away-from-home-base, tax-included purchases.

Sources of Information

Sources of information include:

- Abstract listings,
- FAA listings,
- Airline Annual Reports and SEC Forms 10K,
- Telephone yellow pages, newspaper advertisements, etc.,
- Advertising brochures,
- Tours of airports in your areas or interviews with the president or owner of the airport,
- Federal Aviation Regulations (FAR), and
- Trade Associations.

Appendix Synopsis of Tax Rules

IRC Sections

IRC section 1504(a)

(Affiliated Group Defined)

“* * * For purposes of this subtitle--

(1) IN GENERAL.--The term “affiliated group” means--

(A) 1 or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation, but only if—

(B)(i) the common parent owns directly stock meeting the requirements of paragraph (2) in at least 1 of the other includible corporations, and

(ii) stock meeting the requirements of paragraph (2) in each of the includible corporations (except the common parent) is owned directly by one or more of the other includible corporations.”

IRC section 4041(c)

(Tax on Noncommercial Aviation)

“* * * TAX ON NONGASOLINE FUELS WHERE NO TAX IMPOSED ON FUEL UNDER SECTION 4091.--There is hereby imposed a tax [of 17.5 cents a gallon] upon any liquid (other than any product taxable under section 4081)--

“(A) sold by any person to an owner, lessee, or other operator of an aircraft, for use as a fuel in such aircraft in noncommercial aviation; or

“(B) used by any person as a fuel in an aircraft in noncommercial aviation, unless there was a taxable sale of such liquid under this section.

“* * * No tax shall be imposed by this paragraph on the sale or use of any liquid if there was a taxable sale of such liquid under section 4091.”

* * * * *

IRC section 4261
(Transportation Tax)

“IN GENERAL.--There is hereby imposed upon the amount paid for taxable transportation (as defined in section 4262) of any person a tax equal to 10 percent of the amount so paid. In the case of amounts paid outside of the United States for taxable transportation, the tax imposed by this subsection shall apply only if such transportation begins and ends in the United States.”

IRC section 4262
(Definition of Taxable Transportation)

“(a) * * * For purposes of this part, except as provided in subsection (b), the term ‘taxable transportation’ means--

“(1) transportation by air which begins in the United States or in the 225-mile zone and ends in the United States or in the 225-mile zone; and

“(2) in the case of transportation by air other than transportation described in paragraph (1), that portion of such transportation which is directly or indirectly from one port or station in the United States to another port or station in the United States, but only if such portion is not a part of uninterrupted international air transportation (within the meaning of subsection (c)(3)).”

IRC section 4271
(Transportation of Property Tax)

“(a) * * * --There is hereby imposed upon the amount paid within or without the United States for the taxable transportation (as defined in section 4272) of property a tax equal to 6.25 percent of the amount so paid for such transportation. The tax imposed by this subsection shall apply only to amounts paid to a person engaged in the business of transporting property by air for hire.”

IRC section 4272
(Definition of Taxable Transportation)

“* * * (a) IN GENERAL.--For purposes of this part, except as provided in subsection (b) the term ‘taxable transportation’ means transportation by air which begins and ends in the United States.”

IRC section 4281

(Small Aircraft on Nonestablished Lines)

Exemption from taxes on transportation by air. If an aircraft has a maximum certificated takeoff weight of 6,000 pounds or less and is not operated on an established line, transportation supplied by it shall not be subject to the taxes on air freight and passenger air transportation.

(Taxes are Mutually Exclusive)

Transportation tax and fuel taxes are mutually exclusive. The use of aircraft either is subjected 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.

IRC section 4282

(Affiliated Group Exemption)

“TRANSPORTATION BY AIR FOR OTHER MEMBERS OF AFFILIATED GROUP.

“(a) GENERAL RULE.--Under regulations prescribed by the Secretary, if--

(1) one member of an affiliated group is the owner or lessee of an aircraft, and

(2) such aircraft is not available for hire by persons who are not members of such group, no tax shall be imposed under section 4261 or 4271 upon any payment received by one member of the affiliated group from another member of such group for services furnished to such other member in connection with the use of such aircraft.”

(b) AVAILABILITY FOR HIRE.--For purposes of subsection (a), the determination of whether an aircraft is available for hire by persons who are not members of an affiliated group shall be made on a flight-by-flight basis.”

(Note: Subsection (b) was added by the Small Business Job Protection Act of 1996, effective August 27, 1996.)

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Revenue Rulings

Rev. Rul. 55-534

(Application of Tax to Payment)

“* * * [W]here the transportation of persons involves the services of two or more carriers, the tax only applies to the payments made by, or on behalf of, the passengers for the complete transportation service. The tax does not apply to payments made by the carriers between themselves in settlement of their charges for their respective services even though the payments made to the initial carrier by or for the passengers may have been exempt from the tax. The initial carrier should in such cases furnish to the other carrier or carriers certification that (a) the tax has been collected with respect to the amounts paid by or for the passengers for the complete transportation service, or (b) the payments made by or for the passengers were exempt from the tax. Such a certification by the initial carrier constitutes authority by the other carrier or carriers not to collect the tax.”

Rev. Rul. 55-762

(Time Payment Plan)

“Under a time payment plan for the sale of tickets for the transportation of persons, the time payment differential, which is the amount paid in excess of the established cash fare, is not considered to be a part of the amount paid for transportation, where it is confined to or representative of the added expense incurred by the carrier in selling tickets on the time payment plan.”

Rev. Rul. 57-545

(Application of Payment to Nontransportation Items)

Amounts paid by a company for the lease of an aircraft, including its operation and maintenance for transporting the company's personnel, are subject to the tax. The tax does not apply to payments for nontransportation items if the payments are separable from the payments for rental and operation of the aircraft and are shown separately on the carrier's records.

Rev. Rul. 58-158

(Limitation on Assessment)

“The four-year period of limitation upon assessment, provided by section 3312(a) of the Internal Revenue Code of 1939, does not apply with respect to ‘collected’ excise taxes where no return has been filed and there has been no attempt by either the taxpayer or the collecting agency to see that the tax is received by the Government.”

Rev. Rul. 58-215

(Possession, Command, and Control)

“Where a corporation owns an aircraft and appoints an airline company as its agent to service, maintain, overhaul, and operate [it to transport] the corporation’s personnel, the airline company is not furnishing transportation service * * *. Therefore, amounts paid for [these] services are not [taxable]. * * *”

Rev. Rul. 60-63

(Mixed Loads of Passengers and Freight)

“The tax * * * applies to that portion of a payment made after July 31, 1958, for the service of a carrier chartered to transport mixed loads of freight and passengers which is allocable to the service of transporting the passengers; if no allocation is made, the tax applies to the total payment. * * *”

Rev. Rul. 60-152

(Coastal Gateway)

“Where the only charge made is the established fare for transportation from a coastal gateway point of embarkation to a destination in Hawaii or a foreign destination, and no additional fare is charged for such incidental transportation as may be necessary to bring a passenger to the coastal gateway point of embarkation, no tax on the transportation of persons is collectible for such additional transportation for which no amount is payable by the passenger.”

Rev. Rul. 60-311

(Possession, Command, and Control)

Where the owner of a vehicle (such as a helicopter) leases it to others for the transportation of persons but retains the elements of possession, command, and control of the vehicle and performs all services in connection with the operation of the vehicle, he or she is furnishing a taxable transportation service within the meaning of section 4261 of the Code.

Rev. Rul. 61-13

(Aerial Photographs)

“Amounts paid by an engineering firm for the use of an airplane with the services of a pilot to enable the firm’s employees to take aerial photographs constitute amounts paid for transportation of persons within the meaning of section 4261 of the Internal Revenue Code of 1954. However, if the firm contracts with a company to provide aerial

photographs of a designated area and the company uses its own airplane, pilot and photographers, payments for such service represent amounts paid for the services of aerial photography rather than amounts paid for the transportation of persons by air.”

Rev. Rul. 61-140

(Per Diem Charge)

“Where a helicopter rental company furnishes helicopters with pilots to an oil exploration company for the transportation of its employees and charges a per diem charge plus a fixed hourly charge for actual flying time, and the helicopter is flown with passengers only a part of the time covered by the per diem charge, the excise tax on the transportation of persons, imposed by section 4261 of the Internal Revenue Code of 1954 applies to that portion of the per diem charge and the hourly charge which is allocable to time spent flying passengers.”

Rev. Rul. 63-155

(Hotel Providing Round-Trip Flights)

“A hotel which conducts regularly scheduled round-trip airplane flights from a certain city to the hotel in connection with so-called “package tours” sold to its patrons is furnishing taxable transportation for purposes of the tax on the transportation of persons by air, imposed by section 4261(a) of the Internal Revenue Code of 1954, even though the flights are designated as “free transportation.” Therefore, the amounts paid by patrons for the “package tours” include a charge for taxable transportation, and that portion of the amounts paid for the tours which is reasonably attributable to the transportation service is subject to the tax imposed by that section.”

Rev. Rul. 63-278

(International Flight)

“Where a round-trip ticket for international air transportation is sold in the United States, with the outgoing trip qualifying as “uninterrupted international air transportation” as defined by section 4262(c) (3) of the Code and the return trip is left in an “open” status, the return trip also may be considered as “uninterrupted international air transportation” when the ticket is sold. Therefore, the person receiving payment for the transportation is not required to collect the excise tax on the transportation of persons by air, imposed by section 4261(a) of the Code, with respect to the domestic segments of the round trip. However, subsequent events may require the payment of the excise tax with respect to the domestic segment of the return trip.”

Rev. Rul. 64-6

(International Flight)

“An international air trip in which transportation between two points in the United States is furnished by a commercial airline and the connecting transportation is furnished by the Military Air Transport Service constitutes “uninterrupted international air transportation” within the meaning of section 4262(c)(3) of the Internal Revenue Code of 1954, provided certain conditions relating to prior scheduling and length of stopover are met.”

Rev. Rul. 68-256

(Demonstration Flights)

The IRS has set the rules for taxing transportation of persons by air where a seller of aircraft provides demonstration flight for prospective purchasers.

Rev. Rul. 68-343 (outdated 4282)

(Affiliated Group)

“Where several related or “participating” companies, in order to transport their executive and managerial staff within the United States, use an airplane owned by one of the companies which also furnishes the pilot, amounts paid to the owner-company by the other participating companies as their share of the operating expenses are amounts paid for taxable transportation of persons by air and are subject to the tax imposed by section 4261(a) of the Internal Revenue Code of 1954.”

Rev. Rul. 68-660

(Flying Club)

“The tax imposed by section 4261(a) of the Code applies to that portion of amounts paid by members of a nonprofit ‘flying club’ that is attributable to the cost of taxable transportation service furnished by the club.”

Rev. Rul. 70-325

(Sole Stockholder)

Where the sole stockholder of a corporation leases an aircraft to that company and the company registers, operates, maintains, and services the plane, furnishes the pilot, and provides transportation to the stockholder and his or her employees, business associates, and relatives, the corporation is furnishing a transportation service to the stockholder and other persons. Payments made by them are taxable.

Rev. Rul. 70-381

(Airline Employees)

“Service charges paid by domestic airline employees and their relatives for flights on a ‘space available basis’ are subject to the taxes imposed by section 4261 of the Code.”

Rev. Rul. 70-515

(Travel Cards)

“Amounts paid for travel cards which entitle certain classes of individuals to reduced fares are not subject to the tax on the transportation of persons by air.”

Rev. Rul. 71-126

(Type of Aircraft)

“The tax on transportation of persons by air applies regardless of the type of aircraft employed, [provided all other conditions for liability are present even though such aircraft may not use public or commercial airports.]”

Rev. Rul. 71-398

(Transportation of Property, Accessorial Service)

“Examples illustrate the applicability of the tax imposed by section 4271 of the Code to amounts paid for accessorial services performed by carriers engaged in transporting property by air for [compensation] where charges for such services are separately stated.”

Rev. Rul. 71-445

(Property for Export)

“Property for export shipped by air from one point in the U.S to another and then by boat to a point outside the U.S. is not ‘taxable transportation’; property imported by boat and transshipped by air to various locations in the U.S. is taxable ‘transportation.’”

Rev. Rul. 72-107

(International Flights, Layover Rule)

“Situations illustrate the applicability of the taxes imposed by section 4261 of the Code on transportation of persons by air and the effect of the 6-hour layover rule regarding certain flights.”

Rev. Rul. 72-108

(Free International Flights)

The tax applies to complimentary air transportation furnished solely to participants in package holidays in foreign resorts. The amount paid for these packages includes a charge for air transportation even though it may be advertised as “free.”

Rev. Rul. 72-156

(Aerial Firefighting)

“Sales of aviation fuel for use in aircraft providing aerial firefighting protection are subject to the tax on special fuels, but amounts paid for such services are not subject to the tax on transportation of persons or property by air.”

Rev. Rul. 72-219

(Established Line)

Where both charter flights and regularly scheduled flights are operated by a carrier between two points, both the charter flights and the regularly scheduled flights are considered operated on an established line and are not exempt from the air transportation taxes.

Rev. Rul. 72-233

(International Flights)

“The eight percent tax on transportation of persons by air is applicable to the full amount paid for an air tour of the United States and Mexico which originates and returns to New York City with intermediate stops in Florida, Mexico and California.”

Rev. Rul. 72-286

(International Flights)

“Service charges paid by international airline employees for travel between certain points in the United States are amounts paid for transportation by air irrespective of the fact that the airline is not certificated to operate regular commercial service between such points; Revenue Ruling 70-381 amplified.”

Rev. Rul. 72-309

(Military Personnel)

The international departure tax “applies to each passenger [transported] on commercial aircraft chartered by the U.S. military whether the passenger is in a personal or official travel status.”

Rev. Rul. 72-360

(Primarily Noncommercial Aviation)

“An aircraft operator whose flights are primarily in noncommercial aviation with a limited number of commercial passenger flights is liable for either the aviation fuel tax or the transportation of persons tax on a flight-by-flight basis.”

Rev. Rul. 72-394

(Federal Agency)

The special fuels excise tax applied to aviation fuel sold for use or used in operating aircraft rented by a federal agency from an aviation company for noncommercial aviation purposes.

Rev. Rul. 72-538

(International Flights, United States and Canada)

“Situations illustrate the applicability of the tax on transportation of persons by air with respect to certain travel from Canada to the United States and return.”

Rev. Rul. 72-565

(Additional Charges)

“Amounts paid * * * for charges in connection with layover time of chartered aircraft consisting of an hourly rate plus expenses of the pilot and crew are subject to the taxes imposed on transportation.”

Rev. Rul. 72-585

(Mixed Load of Persons and Property)

“A single amount paid for air transportation of mixed load of persons and property must be allocable on a reasonable basis for purposes of determining the separate taxes applying to transportation of property and the transportation of persons; * * *”

Rev. Rul. 72-617

(Overnight Mail)

Where the carrier provides charter flights for overnight mail services between two points but does not otherwise provide flights between these two points on a regularly scheduled basis, the overnight mail service is not operated on an established line.

Rev. Rul. 73-121

(Noncommercial Aviation)

The special fuels tax did not apply to a commercial aviation company's use of its jet aircraft for training its own pilots since this was a use in the company's business of providing air taxi and charter services. However, the tax did apply when the aircraft was used for training other pilots not employed by the company who were enrolled in the company's training course.

Rev. Rul. 73-86

(Airline)

"The penalty imposed under section 7275(c) of the Code will not apply if air passenger tickets prepared a "fare construction ladder" show the total paid for transportation and tax for each travel segment and the total for all of the segments."

Rev. Rul. 73-212

(Aircraft Diverted from Original Use)

"The purchaser of fuel for use in noncommercial aviation is entitled to a refund of the tax paid on part fuel used after the diversion of the aircraft to foreign trade. either the seller nor the purchaser incurs liability for tax under section 4041(c) for fuel purchased for use in aircraft diverted from foreign trade to a commercial use subject to the transportation taxes. he purchaser of fuel for use in an aircraft diverted from foreign trade to noncommercial aviation is liable for tax on that part of the fuel used after the diversion; Rev. Rul. 69-99 modified."

Rev. Rul. 73-344

(State Taxes Included in Tax Base)

"* * * State sales tax imposed on sellers of air transportation and passed on to their customers as a separately billed item is part of the 'amount paid' for air transportation and is includible in determining the amount upon which the tax on transportation of persons by air is imposed."

Rev. Rul. 73-431

(Federal Credit Unions)

"* * * The exemption from taxes provided Federal credit unions under the Federal Credit Union Act * * * does not apply to the * * * taxes imposed on * * * transportation of persons [by air] * * *."

Rev. Rul. 73-508
(Additional Charge)

“Section 4261(a) of the Internal Revenue Code of 1954 imposes a tax on ‘the amount paid’ for taxable transportation of persons by air. The Civil Aeronautics Board has authorized the airlines to add a charge to their existing passenger tariffs to cover the expenses involved in certain security procedures.

“*Held*, since the described security charge is required to be paid as a condition to receiving air transportation, such charge is part of ‘the amount paid’ for taxable air transportation within the meaning of section 4261(a) of the Code and is subject to the tax imposed by that section.”

Rev. Rul. 74-123
(Government Agency)

“* * * An aviation company operating under a contract with a Government agency to provide domestic air transportation for the agency’s personnel using both government-owned ‘public aircraft’ and company planes is liable for tax on the ‘amount paid’ for transportation on the Government’s aircraft as well as its own. The computation of the tax may be based either on the cash received plus the value of the aircraft used and other agency contributions, or a comparable amount for similar services using a company plane.”

Rev. Rul. 74-181
(International Flights, United States and Canada)

“Rev. Rul. 72-538, 1972, C.B. 577, concerns the applicability of the tax on the transportation of persons by air imposed by section 4261 of the Internal Revenue Code of 1954 to two situations involving a resident of Canada purchasing tickets in Canada for air transportation to points in the United States.

“*Held*, the conclusions in Rev. Rul. 72-538 are applicable not only to the residents of Canada but to any person purchasing such transportation.”

Rev. Rul. 74-537
(International Flights)

“* * * A payment made within the U.S. for a connecting portion of an international journey from Europe to Canada arranged for and scheduled in Europe prior to starting travel with a stopover in New York City of less than six hours is not subject to the tax on transportation of persons by air provided all requirements are section 49.4261-4(c) and (d) of the regulations are met.”

Rev. Rul. 74-538

(International Flights, United States. and Canada)

“* * * Applicability of the taxes imposed by section 4261 of the Code on transportation of persons by air to tickets purchased in New York City for (1) round trip air transportation to Vancouver, within the 225-mile zone, with a stopover of more than 6 hours at Edmonton which is outside the zone on the flight to Vancouver; (2) a flight to Edmonton, surface transportation from Edmonton to Vancouver, and return by air; and (3) round trip air transportation to Edmonton with stopovers of more than 6 hours at Toronto in both directions.”

Rev. Rul. 75-27

(Transportation of Property by Air)

“* * *The tax on transportation of property by air does not apply to amounts charged for the non-U.S. portion of a flight from the continental U.S. to Alaska on either a nonstop flight or a flight with a scheduled stopover in Canada within the 225-mile zone. * * * [O]nly the portion of the flight from the stopover point to the Alaskan border is excluded from the application of the tax.”

Rev. Rul. 75-166

(Air Transportation Over International Waters)

“* * *Examples illustrate the applicability of the tax on air transportation of persons over Canadian territory or international waters between the continental U.S. and Alaska or Hawaii and within Hawaiian Islands or Alaska. Further examples illustrate the applicability of the tax on air transportation of property from Alaska to Whitehorse, Canada, within 225 miles of Alaska but beyond the 225-mile zone, and between points in Alaska with a stopover in Whitehorse. Rev. Ruls. 69-507 and 71-465 superseded.”

Rev. Rul. 75-296

(Transportation of Persons by Air)

“* * *A travel agency that is an independent broker licensed by the ICC and sells tours in aircraft it charters is required to collect the transportation tax, file returns, and pay the tax to the Government. However, a travel agency that sells tours as the agent of an airline must collect the tax and remit it to the airline for the filing of returns and payment of the tax.”

Rev. Rul. 75-535

(Transportation; Air Ambulance Service)

“* * *Amounts paid for air flight and stand-by time furnished by a nonprofit organization in connection with its unscheduled U.S. air ambulance service, using aircraft having maximum certificated weights in excess of 6,000 pounds, are subject to the tax on transportation of persons imposed by section 4261(a) of the Code.”

Rev. Rul. 76-394

(Stockholders and Aircraft Ownership)

Where voting power or stock ownership was vested in individual shareholders who held a common interest in several companies, there was no common parent company and companies participating in the use of an aircraft were not an affiliated group.

“* * *Situations illustrate whether amounts paid to a company by its wholly owned subsidiary and other companies in which its stockholders have a substantial interest, or a controlling interest and are officers and directors, under an agreement whereby the companies share in the operating expenses of an aircraft based on their percentage of use, are amounts paid for the transportation of persons by air for purposes of the tax imposed by section 4261 of the Code and whether such amounts come within the exemption from the tax provided by section 4282(a) for members of an affiliated group Rev. Rul. 68-343 superseded.”

Rev. Rul. 76-58

(Flight Testing)

“* * *The taxability is explained for jet fuel used in preflight testing, flight testing and “first tank fill-ups” by a jet aircraft manufacturer that also repairs used aircraft and whose customers included the armed forces of the U.S. and foreign countries, noncommercial operators, and commercial airlines. Rev. Rul. 66-349 superseded.”

Rev. Rul. 76-431

(Corporation Shareholders)

“Aircraft owned and operated for exclusive use of corporation’s shareholders. A corporation that employs a full-time pilot to fly an aircraft which it owns and maintains for use exclusively by its shareholders, each of whom establish the schedule and destinations of flights and is charged an amount for flight service based either on an hourly rate or on the number of miles flown, is engaged in selling transportation services and is subject to the taxes imposed by sections 4261(a) and 4271(a) rather than section 4041(c) of the Code.”

Rev. Rul. 76-477

(Federal Agency and Helicopters)

“* * *A contractor providing and controlling the pilots, maintenance and fuel for helicopters provided to a Federal agency for its administrative activities and for forest fire detection, reconnaissance and suppression is furnishing transportation service taxable under section 4261 or 4271 of the Code when transporting agency personnel or property. However, the tax imposed on aviation fuel by section 4041(c) applies to helicopter use for the agency with only the contractor’s employees aboard, such as flights to spot fires or drop fire retardant chemicals.”

Rev. Rul. 76-550

(Municipal Associations)

“* * * Municipal associations composed of towns and cities of their respective states and organized exclusively for public purposes come within the scope of the exemption from retailers, manufacturers and communications taxes but are subject to the tax on air transportation; Rev. Rul. 58-1567 superseded.”

Rev. Rul. 76-556

(Helicopters)

Fuel used by helicopters having maximum certified takeoff weight of 6,000 pounds or less in flights wherein employees of the company that rented the helicopters were transported to and from job sites were subject to tax.

Rev. Rul. 77-75

(Air Ambulance Service)

“* * * Rev. Rul. 75-535, 1975-2 C.B. 438, concludes that amounts paid for air flight and stand-by time, in connection with unscheduled air ambulance service furnished by a nonprofit organization, are subject to the tax on the transportation of persons by air imposed by section 4261(a) of the Internal Revenue Code of 1954. Under the facts in that Revenue Ruling, patients being transported also incurred inflight medical costs that were separately billed.

“*Held*, the amounts paid for the inflight medical costs are not subject to the tax imposed by section 4261(a) of the Code.

“Rev. Rul. 75-535 is amplified.”

Rev. Rul. 77-405

(Affiliated Group)

“* * * For purposes of the exemption provided by Section 4282(a) of the Code, the determination of whether the aircraft of an affiliated group is available for hire by persons not members of the group may not be made on a flight by flight basis; if the section 4282(a) exemption does not apply, the determination of whether the aviation fuel taxes apply * * * will [then] be made on a flight by flight basis. Rev. Rul. 72-360 amplified. (Note: The Small Business Job Protection Act of 1996 amended Section 4282. It now specifies that the exemption will be determined on a flight by flight basis.)”

Rev. Rul. 78-75

(Definition of Commercial Operator)

“Aviation fuel and transportation. FAA status. The status of an aircraft operator as a ‘commercial operator’ under Federal Aviation Administration regulations is not determinative in applying the aviation fuel and transportation taxes* * *.”

Rev. Rul. 79-29

(Cessation of Availability to Outsiders)

“* * *An affiliated group’s aircraft that had ceased to be made available for hire to persons outside the affiliated group is eligible for the transportation tax exemption provided by section 4282(a) of the Code; Rev. Rul. 77-405 amplified.”

Rev. Rul. 79-355

(State Agencies)

IRC section 4261(a) tax on transportation of persons by air does not apply to non-cash transactions between state agencies for transportation of their employees for official business on state-owned aircraft. These air transportation transactions were merely allocations of operating costs between different divisions of the state. They were not taxable “amounts paid” because such payments require at least two distinct entities for purposes of the IRC section 4261(a) tax.

Rev. Rul. 80-31

(Service Charge)

“The service charge added by an airline or airline agency to the price of a ticket for taxable transportation to cover administrative costs involving use of the ticket by a different person in a different city is not subject to the tax imposed by section 4261(a) of the Code; Rev. Rul. 77-392 revoked.”

Rev. Rul. 80-53

(Postal Service; Airport Terminal Handling Charges)

“Terminal handling charges paid by the U.S. Postal Service to scheduled certificated air carriers for services in connection with handling mail at the airport are not subject to the tax imposed by section 4271(a) of the Code; Rev. Rule. 74-512 revoked.”

Rev. Rul. 81-197

(Leasing and Chartering of Aircraft)

“Amounts received by an electing small business corporation from the ‘dry’ lease of an aircraft are rents within the meaning of Section 1372(e)(5)(C) of the Code, but amount received from the full-service charter of an aircraft are not rents.”

Rev. Rul. 83-165

(Who Must Pay Tax)

As a general rule, all users are subject to excise taxes on the amount paid for taxable transportation of persons by air. The only exemptions are provided for certain helicopter uses, Code Section 4261(e), certain small aircraft, Code Section 4281, and certain affiliated groups Code Section 4282.

Rev. Rul. 84-12

(Free Bonus Tickets)

The tax imposed by section 4261(a) of the Code does not apply in the case of free bonus tickets issued by an airline company to customers who have already satisfied all requirements to qualify for the bonus. In the case of an advance bonus ticket issued to a customer, this tax also will not apply at the time such bonus ticket is used. However, this tax will apply to any amount that a customer subsequently pays in respect of an advance bonus ticket because of traveling insufficient mileage to fully qualify for the free advance bonus ticket.

Rev. Rul. 85-36

(Uninterrupted International Flights)

“If a ticket is purchased for domestic air transportation and such domestic air travel is part of uninterrupted international air transportation as defined in section 4262(c) (3) of the Code, the fact that the tickets are purchased separately from two different air carriers that do not have an interline agreement does not make the domestic portion of the trip subject to the tax, provided all other requirements have been met for exclusion.”

Rev. Rul. 86-137

(International Flights)

“Collection of \$3.00 tax on use of international travel facilities; payment made outside U.S. to foreign charterer. When a payment for air transportation that is subject to the \$3.00 tax is made outside the U.S. to a foreign charterer, the airline that furnishes the transportation triggering the \$3.00 tax is required to collect, report and pay the tax. Rev. Rul. 75-296 distinguished.

Rev. Rul. 87-133

(International Flights, 225-Mile Zone)

Airfare paid on board a flight from a city in the continental United States to a city located in the 225-mile zone is an amount paid in the United States for purposes of section 4261(a) of the Code. Airfare paid on board a flight from a city located in the 225-mile zone to a city in the continental United States is an amount paid outside the United States and is not subject to the tax.

Rev. Rul. 91-61

(Passenger Facility Charges)

Passenger facility charges imposed by local airports under the Federal Aviation Act of 1958 are not subject to the transportation tax.

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Court Cases

***Las Vegas Hacienda, Inc. v. Civil Aeronautics Board*, 298 F.2d 430(1962)**

(Package Tours)

A resort hotel operator selling package tours from a city in another state, including “free” airplane rides on its aircraft, was a common carrier for compensation. This holding was followed in Revenue Ruling 63-155, 1963-2 C.B. 566, where it was held that amounts paid by hotel customers for the package tours include a charge for taxable transportation, and that portion of the amounts paid for the tours which is reasonably attributable to the transportation service is subject to the transportation tax.

***Falcon Jet Corp. v. United States*, 81-1 U.S.T.C. 16,361**

(Noncommercial Aviation)

A corporation that leased aircraft and provided flight training for Japanese airline pilots was engaged in noncommercial aviation.

***Petit Jean Air Service, Inc. v. United States*, 74-1 U.S.T.C. 16,135**

(Nontaxable Activity)

Since the leasing of an aircraft by an individual was a nontaxable activity, revenue derived by the taxpayer was not payment for the transportation of persons and was not taxable. However, with respect to other users of the aircraft, the revenue did constitute payment for transportation. In regard to the excise taxes collected on these payments for transportation, the taxpayer’s refund suit was denied. The taxpayer failed to show that it had repaid the taxes collected to the aircraft users or that it had obtained their consents to bring a refund suit.

***Air Tour Acquisition Corp d.b.a. Panorama Air Tour v. United States*, DC 92-1 U.S.T.C. 50,189**

(Excise Tax)

A tour company was not liable, under Code Section 7501, for uncollected excise taxes on air transportation that the IRS claimed were due. The IRS was incorrect in claiming that a trust was created for the proper amount of tax due, rather than the amount collected. However although the company was the prevailing party in the lawsuit, it was not entitled to an award of litigation costs, because it failed to establish that the position of the Government was not substantially justified.

***Shell Oil Company v. United States*, 79-2 U.S.T.C. 16,322**
(Guaranteed Availability)

Transportation tax applies to both the hourly rate for actual use and the monthly charge guaranteeing availability of service. Congress did not restrict tax to direct charges for aircraft flights that use public airports and airways.

Glossary

Air Taxi. FAA's terminology for air charter service. A Part 135 Operator.

Air Carrier Operating Certificate. Operators that meet the comprehensive criteria of the FAA in order to do business.

Air Charter Service. Air services provided to a specific location specified by the customer. An air charter service does not normally have regularly scheduled flights.

Airport and Airway Trust Fund. Funds used for planning, research, development, construction, operation, and maintenance of air traffic control, air navigation, communications, and supporting services. Revenue for the fund is collected from the imposition of tax under IRC sections 4041, 4261, and 4271.

AMADEUS. European reservation system.

APOLLO. United Airlines reservation system.

ARAC. Aviation Rulemaking Advisory Committee.

ARC (Airline Reporting Corporation). ARC (formerly ATC or Air Traffic Conference). A regulatory authority that acts a clearinghouse for airline ticket sales for most Western Hemisphere carriers, including travel agents and tour operators, as well as for Amtrak ticket sales.

ASTA (American Society of Travel Agents). A trade association of travel agencies and related industries.

ATA (Air Transportation Association of America). A trade and service organization representing member U.S. scheduled airlines. The joint interests of the airlines as an industry are expressed through a system of councils and related committees on which airline and ATA representatives work together.

ATC (Air Traffic Conference). Now called "ARC" (Airline Reporting Corporation).

Auditor's Coupon. The initial document contained in each ticket booklet. This coupon is lifted (detached from the ticket booklet) by the carrier providing the transportation service at the boarding as evidence of the service rendered. The auditor's coupon is used to record the sale and all related accounting information, including the passengers tax.

CAP (Civil Air Patrol). A volunteer civilian auxiliary of the U.S. Air Force.

Certificated Air Carrier. The holder of a Certificate of Public Convenience and Necessity issued by the Civil Aeronautics Board.

Certificated Weight. Also referred to as “takeoff weight.” The certificated weight is the maximum takeoff weight contained in an aircraft’s Certificate of Airworthiness.

Civil Aircraft. Any engine-driven aircraft registered under Section 501(a) of the FAA or any engine-driven aircraft not registered under Section 501(a) but owned by or for a United States person.

CLIA (Cruise Lines International Association). A regulatory organization whose membership comprises major cruise lines.

Coupons. An airline ticket is a booklet that consists of several coupons indicating the itinerary of the passenger. The airline ticket includes an auditor’s coupon, flight coupons, and a passenger receipt.

Deadhead Service. An empty aircraft returning to its base or going to pick up cargo or passengers.

DOT. Department of Transportation.

Dry Lease. The lease of aircraft only. The lessee provides its own crew or pilot. Because control is transferred to the lessee, the payment is for a rental of the aircraft rather than for taxable transportation.

Established Line. A line operating with some degree of regularity between definite points.

FAA (Federal Aviation Administration). Founded in 1958, the FAA absorbed the Civil Aeronautics Administration, Airways Modernization Board, and all safety rulemaking functions of the Civil Aeronautics Board.

Flight Coupon. Tickets that represent each segment (leg) of a passenger’s itinerary.

IATA (International Air Transport Association). A regulatory organization of international air carriers that negotiates international air fares, cargo rates, conditions of service, and ancillary matters. Any agreement reached by the carriers at the IATA meetings is subject to the approval of their respective governments.

Interline Agreement. An agreement allowed by regulatory authority which simplifies the ticketing process and prorates the fare among the carriers providing the services.

Lift. Industry term used to indicate that a coupon has been detached from the airline ticket booklet or “lifted.”

MCO (Miscellaneous Charges Order). An order used to record miscellaneous items.

OL. A ticket sold by an airline and ultimately used on that airline is referred to as an “online” (OL) sale.

OAL. A ticket sold by one airline and used on another airline is referred to as an “offline” (OAL) sale.

PARS. Trans World Airlines reservation system.

PFCs (Passenger Facility Charges). Specified per passenger charges at commercial service airports used to finance airport improvements. PFCs are collected and disbursed by the air carrier to the airport designated on the airline ticket. PFCs are excluded from tax under IRC section 4261.

PTA. Prepaid Ticket Advice.

REN (Refund/Exchange Notice). A notice used to record refunds and exchanges.

Reservation System. A network of computer terminals through which a travel agent researches air travel arrangements, makes reservations, and issues tickets. Examples are the SABRE and APOLLO systems.

SABER. American Airlines reservation system.

Station Sales. Sales made at the airlines airport station, at other sales locations, via mail, or via telephone which are usually from one central or several regional reservation centers.

SYSTEM ONE. Continental Airlines reservation system.

Ticket Stock. Blank ticket booklets consisting of coupons that are completed and validated to allow air travel. The booklet of ticket stock bears a number, and the ticket stock is issued in sequential order. Air carriers use their own airline ticket stock unless an agreement has been made to allow another carrier to use their ticket stock.

Tour Operator. An entity that packages or markets inclusive tours and sells them through travel agents or directly to the public. It may provide tour services with its own facilities or may subcontract the services.

Tour Organizer. Someone who assembles a group for a special prepaid tour.

Tour Wholesaler. An entity that creates and markets inclusive tours and foreign independent travel through travel agents. Often used interchangeably with “tour operator.”

Travel Agency. An agency that arranges for travel services from suppliers such as airlines, hotels, car rental companies, and cruise lines. A travel agency can operate at the retail level, the wholesale level, or both.

USAR (Uniform System of Accounts and Reports). Air carrier accounting information is classified under the USAR, which consists of a list of titles and account numbers to be used by air line carriers.

Validation. The imprinting of airline ticket stock with the stamp that makes it a legal ticket.

Wet Lease. The lease of aircraft including crew and other services as part of the lease. The lessor maintains control of the aircraft, and amounts paid for the lease are subject to tax.

Wholesale Agency. An agency that assembles and sells “packages” of travel services. A wholesale agency earns its income by securing blocks of reservations and reselling them at a markup, usually through retail agencies.

WORLDSPAN. Delta Airlines reservation system.

225-Mile Zone. That portion of Canada and Mexico that is not more than 225 miles from the nearest point in the continental United States.