



## Market Segment Specialization Program



# Air Charters

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Department of the Treasury  
Internal Revenue Service

Training 3149-107 (5-93)  
TPDS 831890

**TABLE OF CONTENTS**

	<b>Page</b>
I. INTRODUCTION TO AIR CHARTER INDUSTRY .....	1
II. SOURCES OF AUDITS.....	2
III. APPOINTMENT AND INFORMATION DOCUMENT REQUEST.....	3
IV. INFORMATION TO BE OBTAINED DURING INITIAL INTERVIEW.	3
V. FUEL TAX LAW AND AUDIT ISSUES .....	4
A. Aviation Fuel .....	4
B. Common Audit Adjustments - Aviation Fuel.....	4
C. Retail Tax on Aviation Gasoline .....	4
D. Common Audit Adjustments - Aviation Gasoline....	5
VI. FUEL TAX AUDIT STEPS .....	5
A. Aviation Fuel - IRS #69 .....	5
B. Retail Tax on Gasoline Sold for Use or Used in Noncommercial Aviation - IRS #14.....	6
C. Floor Stock Tax on Aviation Fuel IRS #87 and Gasoline - IRS #65 .....	7
VII. AIR TRANSPORTATION TAX LAW AND AUDIT ISSUES.....	7
A. General Rule .....	7
B. Exemptions From Transportation Tax .....	9
C. Computation of Tax Due .....	11
D. Leases .....	14
E. State and Federal Governmental Agencies .....	17
F. Audit Issues .....	17
VIII. AIR TRANSPORTATION TAX AUDIT STEPS .....	18
IX. FUEL TAX CREDITS AND REFUNDS .....	19
X. EXAMINATION PROCEDURES OF COLLECTING AGENCIES .....	21

**AUDITING  
OF  
AIR CHARTER COMPANIES**

**I. INTRODUCTION TO AIR CHARTER INDUSTRY**

Generally, all aircraft flights are subject to either the taxes on air transportation of persons (IRC section 4261 and property (IRC section 4271) or the fuel taxes (IRC sections 4041, 4081, 4091). Generally, commercial flights are subject to the transportation taxes while noncommercial flights are subject to the fuel taxes. The very limited exceptions from these taxes are discussed below. Which set of taxes applies is determined on a flight-by-flight basis. See Revenue Ruling 72-360, 1972-2 C.B. 542, as amplified by Revenue Ruling 77-405, 1977-2 C.B. 381.

The person paying for taxable transportation is liable for the transportation tax and, ordinarily, the person receiving the payment must collect the tax and file the returns.

A travel agency that is an independent broker is required to collect the transportation tax, file the returns, and pay over the tax. 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 for the payment of the tax. See Revenue Ruling 75-296, 1975-2 C.B. 440.

The term "noncommercial aviation" means any use of an aircraft other than use in the business of transporting persons or property for compensation or hire. Any personal use of an aircraft by the owner, lessee, or other operator of an aircraft is considered use of the aircraft in noncommercial aviation. This includes such flights as family trips and pleasure flying. The term "noncommercial aviation" also applies to transportation in an aircraft with a maximum certificated take-off weight of 6,000 pounds or less, except when the aircraft is operated on an established line [see Treas. Reg. section 49.4263-5 (c)]; or transportation in an aircraft that is owned or leased by a member of an affiliated group and is not available for hire to nonmembers.

In contrast, "commercial aviation" is the transportation of persons or property for compensation, including scheduled or established line flights, passenger (or freight) air charter flights and use of aircraft owned by an air carrier to train pilots and carry airline personnel on company business flights.

The Service is not bound by other agencies' definitions of commercial and noncommercial aviation. Revenue Ruling 78-75, 1978-1 C.B. 340, states that the status of an aircraft operator as a "commercial operator" under FAA regulations is not determinative of the commercial or noncommercial status of the operator when applying the aviation fuel and air transportation taxes.

Revenue Ruling 72-156, 1972-1 C.B. 331, states that sales of aviation fuel for use in aircraft carrying loads of fire retardant and providing aerial fire-fighting protection, with only air charter company employees aboard the aircraft, are subject to the fuel tax, and amounts paid for such services are not subject to the transportation taxes. But, if personnel who are not employees of the charter company are also being transported, the air transportation tax and not the fuel tax applies. See Revenue Ruling 76-477, 1976-2 C.B. 329.

**Caution:** These revenue ruling may be inapplicable if helicopters are used because of the exemption in IRC section 4261(e) (discussed later) for helicopters used in caring for trees.

Registered procedures may sell aviation fuel at a tax-reduced rate of \$0.001 per gallon to a registered commercial aircraft operator for use as fuel in commercial aviation. See Notice 88-132, 1988-2 C.B. 552.

If a person engaged in commercial aviation uses fuel on which tax has been imposed, a refund or credit may be available to the ultimate purchaser. However, the Leaking Underground Storage Tank (LUST) tax of \$0.001 per gallon is not refundable for aircraft engaged in commercial aviation, unless the fuel is generally used in the international or military flights. See IRC section 6427(1)(3). Air charter companies registered as commercial airlines can buy aviation fuel at the LUST rate (rather than the full rate) only if they are registered and certified that the fuel will be used for commercial aviation. See IRC section 4093(c) for information on exempt uses and registration requirements.

The air charter industry is different from the commercial airline industry since an air charter company does not generally have regularly scheduled flights. Rather, flight services are to specific locations dictated by the individual chartering an aircraft.

Noncompliance has been noted in the air charter industry. Air charter entities are sometimes using an incorrect tax base when computing the amount of transportation tax to be collected and are improperly exempting various types of entities from transportation tax. Also, these entities may not have paid the retail tax on the gallon of gasoline sold or used in an aircraft for noncommercial aviation.

The law pertaining to the air charter industry is primarily located in the Code and revenue rulings which are very time consuming for auditors to research. Therefore, this audit specialization program has been written as a tool to aid individuals auditing the air charter industry. Also, Publication 510, Excise Taxes for 1993, and Publication 378, Fuel Tax Credits and Refunds, can be used as ready reference guides.

**Caution:** The air transportation regulations (26 CFR Part 49) do not reflect current rates or changes made since the Airport and Airway Revenue Act of 1970; also, many revenue rulings do not reflect current tax rates.

## **II. IDENTIFICATION OF TAXPAYERS**

- A. Abstract listings - IRS #69, #14, #26, #27 and #28. (See Form 720, Quarterly Federal Excise Tax Return.)
- B. Yellow pages of telephone book under air charter or aircraft lease.
- C. Airport terminal.
- D. Taxpayers currently under audit for names of competitors.
- E. Advertising materials of taxpayer under audit.

## **III. APPOINTMENT AND INFORMATION DOCUMENT REQUEST**

See the attached sample - EXHIBIT 1, Page 23.

## **IV. INFORMATION TO BE OBTAINED DURING INITIAL INTERVIEW**

The information obtained during the initial interview is helpful in determining the scope of the audit. The following questions should be asked:

- A. Does your company sell aviation fuel or aviation gasoline?
- B. Who are your main fuel suppliers?

- C. Does your company use aviation fuel or aviation gasoline?
- D. Does your company have any customers who purchase aviation fuel or aviation gasoline without federal excise tax? If so, obtain a list of these customers.
- E. Does your company purchase fuel using a Form 637 registration number?

V. **FUEL TAX LAW AND AUDIT ISSUES**

A. **Aviation Fuel.**

IRC section 4091 imposes a tax of 14.1 cents per gallon before 9/1/90, 14 cents per gallon between 9/1/90 and 11/30/90, and 17.6 cents per gallon after 11/30/90 on any aviation fuel (other than gasoline) sold by the producer thereof unless the rules for exempt sales in Notice 88-132, 1998-2 C.B. 552, are met. If a charter operator buys aviation fuel tax free and then uses it in noncommercial aviation, then the charter operator is liable for fuel tax.

Remember, if the air transportation is exempt from IRC section 4261 or 4271 taxes because of IRC section 4281 (exemption for small aircraft on non-established lines) or IRC section 4282 (exemption for affiliated group), the fuel tax will apply because the fuel is considered as being used in noncommercial aviation. See IRC section 4041(c)(4).

B. **Common Audit Adjustments - Aviation Fuel.**

To date, a high degree of compliance has been noted in this area.

C. **Retail Tax on Aviation Gasoline.**

IRC section 4041(c)(2) imposes tax at the rate of three cents per gallon before 11/30/90 and one cent per gallon after 12/1/90. The tax is imposed on all gasoline sold for use or used in aircraft in noncommercial aviation. However, if transportation tax applies to a flight, then fuel tax is not applicable and vice versa. Remember, IRC section 4041(c)(2) tax is in addition to the to the IRC

section 4081 tax (now 14.1 cents per gallon) that has already been imposed by the time the retailer gets the gasoline.

If the air transportation is exempt from IRC section 4261 or 4271 taxes because of IRC section 4281 (exemption for small aircraft on nonestablished lines) or IRC section 4282 (exemption for affiliated group), the fuel tax will apply because the fuel is considered as being used in noncommercial aviation. See IRC section 4041(c)(4).

**D. Common Audit Adjustments - Aviation Gasoline.**

Retailers of aviation gasoline may incorrectly compute total taxable disposal; thus, understating total retail tax liability. Retailers may not have paid tax on aviation gasoline used in their own businesses. The tax applies to fuel sold for use or used by the taxpayer in aircraft in noncommercial aviation.

**VI. FUEL TAX AUDIT STEPS**

**A. Aviation Fuel - IRS #69.**

The taxable event is the sale of aviation fuel by the producer. The producer is liable for the tax unless the rules for exempt sales in Notice 88-132, 1988-2 C.B. 552, are met. For these taxpayers, reconcile inventory records to verify that all gallons of aviation fuel disposed of during a quarter have been accounted for on the Form 8743, an attachment to Form 720. Trace beginning and ending inventories as reported on the Form 8743 to the inventory meter readings taken during the quarter. Inspect purchase invoices and reconcile total gallons purchased to total purchases as indicated on the Form 8743. Analyze and explain discrepancies.

Determine if any claim for refund was filed. If tax paid aviation fuel was used by the claimant in commercial aviation, then a credit or refund may be made, verify that these sales were to qualified purchasers.

While inspecting the purchase invoices for aviation fuel of persons who are not registered on Form 637, determine whether these taxes have been passed on to the buyer by its supplier. 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 as this may indicate that the supplier is not paying the tax. If a charter company bought tax-paid aviation fuel and then sold it at a tax-excluded price to another person, no refund is available to the charter company that sold the aviation fuel at a tax-excluded price.

If a charter company bought tax-paid aviation fuel and then used it in commercial aviation, a credit or refund of the fuel tax may be available.

B. **Retail Tax on Gasoline Sold for Use or Used in Noncommercial Aviation - IRS #14.**

The taxable event is the use or sale for use of gasoline in aircraft in noncommercial aviation. See IRC section 48.4041-5. The person making the sale for use or using the gasoline is liable for the tax. The tax is three cents per gallon before 12/1/90 and one cent per gallon after 11/30/90 on the gasoline so sold or used. For these taxpayers, reconcile inventory records to verify that all gallons of aviation gasoline disposed of during a quarter have been accounted for on the Form 8743. Trace beginning and ending inventories as indicated on the Form 8743 to the inventory meter readings taken during the quarter. Inspect purchase invoices and reconcile total gallons purchased to total purchases as indicated on Form 8743. Analyze and explain discrepancies.

While inspecting the purchase invoices for aviation gasoline, determine whether fuel taxes of 9.1 cents per gallon before 12/1/90, and 14.1 cents per gallon after 11/30/90, have been passed on to the 637 registrant by the fuel supplier. If the taxes have not been passed on, there are no excise tax consequences to the buyer; but you may consider auditing the supplier as this may indicate that the supplier is not paying the tax.

Verify that the retail tax of three cents per gallon before 12/1/90, or one cent per gallon after 11/30/90, has been reported on all taxable gallons of aviation gasoline disposed of during the quarter. Multiply the total gallons of aviation gasoline disposed of as indicated on the Form 8743 by the applicable tax rate and reconcile to the amount of tax reported on the Form 720 (IRS #14). Resolve any discrepancies.

C. **Floor Stock Tax on Aviation Fuel IRS #87 and Gasoline - IRS #65.**

Inspect Form 720 for the quarter ended 3/31/91, to verify if the taxpayer paid the appropriate floor stock tax. Both the return and payment were due 5/31/91.

Determine the taxpayer's inventory of gasoline and aviation fuel as of 12/1/90. Multiply the total gallon of gasoline on hand as of 12/1/90 by 5 cents per gallon. Multiply the total gallons of aviation fuel on hand as of 12/1/90, by 3.5 cents per gallon. Determine whether these amounts have been reported on the Form 720 for the quarter ended 3/31/91. See section 42.4 of the regulations for exemptions from the fuel floor stocks tax.

VII. **AIR TRANSPORTATION TAX LAW AND AUDIT ISSUES**

A. **General Rules.**

1. **Transportation of Persons by Air.**

IRC section 4261(a) imposes upon the amount paid for taxable transportation (as defined in IRC section 4262) of any person a tax equal to 8 percent before 12/1/90, and 10 percent after 11/30/90 of the amount so paid.

2. **International Departure Tax.**

IRC section 4261(c) imposes a tax of \$3.00 before 1/1/90, and \$6.00 after 12/31/89, on any amount paid (whether within or without the United States) for any transportation of any person by air if such transportation begins in the United States, even if the flight is the return part of a round trip from a foreign country. This tax does not apply, however, to any payment if the 10 percent tax fully applies to the payment.

3. **Definition of Taxable Transportation of Persons.**

IRC section 4262 - transportation by air which begins and ends in the United States or in the 225 mile zone, and the domestic portion of transportation by air which is not a part of an uninterrupted international air transportation (as defined in IRC section 4262(c)(3)). See IRC section 4262(b) and 4263(f) for exclusions.

4. **Examples.**

An amount paid (whether within or without the United States) for the transportation of a person by air from Boise to Denver is subject to the 10-percent tax.

An amount paid within the United States for the transportation of a person by air from Boise to Vancouver, Canada, (within 225-mile zone) is subject to the 10-percent tax, but not the \$6.00 tax. If paid outside the United States, it is not subject to the 10-percent tax (but is subject to the \$6.00 tax).

An amount paid (whether within or without the United States) for the transportation of a person by air for Boise to Edmonton, Canada, (not within 225-mile zone) is not subject to the 10-percent tax, but is subject to the \$6.00 tax.

An amount paid within the United States for transportation of a person by air from Boise to London, England, with a scheduled stopover in Detroit of 24 hours. The portion of the amount paid attributable to the transportation from Boise to Detroit is subject to the 10-percent tax because it is not part of an uninterrupted international air transportation. Also, the portion of the amount paid attributable to the transportation for Detroit to London is subject to the \$6.00 tax. If the scheduled stopover in Detroit is not more than twelve hours, only the \$6.00 tax applies because the transportation is uninterrupted international air transportation.

An amount is paid for the transportation of a person by air nonstop from a point in the continental United States to a point in Alaska or Hawaii. Portions of the flight are over Canadian territory or international waters. The portion of any flight between the continental United States (or the 225-mile zone) and Alaska or Hawaii that is over Canadian territory or over international waters is exempt from the 10-percent tax because it meets all four requirements of IRC section 4262(b). Because the transportation began in the United States and the transportation is not all taxable transportation subject to the 10-percent tax, the \$6.00 tax applies to amounts paid for the transportation. In addition, the 10-percent tax is applicable to the portion of the transporta-

tion determined to be taxable transportation under the method of computation set forth in Treas. Reg. section 49.4262 (b)-1(c). See Revenue Ruling 75-166, 1975-1 C.B. 352.

4. **Transportation of Property By Air.**

IRC section 4271 imposes upon the amount paid for taxable transportation of property a tax equal to 5 percent before 12/1/90, and 6.25 percent after 11/30/90, of the amount so paid. Under IRC section 4272 the term "taxable transportation" of property mean transportation by air which begins and ends in the United States. See IRC section 4272 (b) for exceptions.

B. **Exemptions From Transportation Tax.**

1. **Small Aircraft on Nonestablished Lines.**

IRC section 4281 provides that the tax imposed by IRC sections 4261 and 4271 does not apply to amounts paid for transportation by an aircraft having a maximum certificated take-off weight of 6,000 pounds or less, except if the aircraft is operated on an established line. Maximum certificated take-off weight means the maximum take-off weight contained in the type certificate or airworthiness certificate. An established route is a flight path which is made with any regularity. See Treas. Reg. section 49.4263-5(c).

Revenue Ruling 72-219, 1972-1 C.B. 350, states that the exemption from transportation tax for small aircraft on nonestablished lines does not apply to unscheduled flights by an airline that also operates a regularly scheduled air service between the same two points.

2. **Affiliated Groups.**

IRC section 4282 provides that if one member of an affiliated group is the owner of lessee of an aircraft and such aircraft is not available for hire by persons who are not members of such group, no tax is imposed under IRC sections 4261 and 4271 upon any payment received by one member of an affiliated group for services provided by another member of the affiliated group.

If an aircraft of an affiliated group is available for hire by non-affiliated person, then the affiliated group exemption does not apply. For examples, see Revenue Rulings 76-394, 1976-2 C.B. 355; 77-405, 1977-2 C.B. 381; and 79-29, 1979-1 C.B. 358.

3. **Certain Helicopter Uses.**

IRC sections 4261(e) and (f) provide that no tax is imposed by IRC section 4261 or 4271 on amounts paid for air transportation by helicopter for purpose of:

- (a) Transporting individuals, equipment, or supplies in the exploration for, or the development or removal of, hard minerals, oil, or gas; or
- (b) Planting, cultivation, cutting, or transportation of, or caring for, trees (including logging operations); or
- (c) Providing emergency medical services;

BUT only if the helicopter does not take off from, or land at, a facility eligible for assistance under the Airport and Airway Development Act of 1970, or otherwise use services provided pursuant to the Airport and Airway Improvement Act of 1982 during such use.

4. **Excess Baggage of Passengers.**

IRC section 4272(c) provides that no transportation tax is imposed on amounts paid for excess baggage accompanying a passenger traveling on an aircraft operated on an established line.

5. **Revenue Ruling 83-165, 1993-2 C.B. 197**

All users are subject to the taxes imposed by IRC sections 4261 and 4271 on amounts paid for taxable air transportation of persons and property. The only exemptions are those for certain helicopter uses, small aircraft on nonestablished lines and affiliated groups. The revenue ruling also restates the holdings of other revenue rulings that certain specific users are subject to air transportation taxes: 72-10, 1972-1 C.B. 343, foreign governments and employees of international organizations; 72-11, 1972-1 C.B. 344, certain organizations created

by Congressional legislation even though the statutes creating many of the organizations provided that they be exempt from federal taxation; 73-198, 1973-1 C.B. 425, diplomats and consular officials of foreign governments whether engaged in official or personal travel or business; 78-155, 1978-1 C.B. 362 all users.

6. **Revenue Ruling 91-61, 1991-2 C.B.**

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

C. **Computation of Tax Due.**

1. **Computation.**

Transportation tax due under IRC sections 4261 and 4271 is to be computed by multiplying the total payment for transportation by the applicable tax rate. The tax rate used will depend on the date of transportation and whether persons or property were transported.

Treas. Reg. section 49.4261-2(c) of regulations states that if a payment covers charges for nontransportation services (such as charges for off-plane meals, hotel accommodations, etc.), as well as for transportation of a person, the charges for the nontransportation services may be excluded in computing the tax payable with respect to such payment; provided such charges are separable and are shown in the exact amounts in the records pertaining to the transportation charge. If the charges for nontransportation services are not separable from the charge for transportation of the person, the tax must be computed upon the full amount of the payment.

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 Revenue Ruling 63-155, 1963-2 C.B. 566, where it was held that amounts paid by hotel customers for the package tours includes a charges 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.

Revenue Ruling 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 under IRC section 4261 on the part of the payment that represents the amount charged for 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.

2. **Administrative Provisions.**

IRC section 7275 imposes a penalty for offenses relating to certain airline tickets. Basically, all tickets fully subject to the 10-percent tax must show the cost of the transportation and the excise tax separately. When air fares are advertised, the total cost of the ticket (including the tax) should be advertised as the price of the ticket. If the fare and the tax are separately stated, the total of both must be stated at least as prominently as the larger of the two amounts.

**Example.**

Franklin Jenkins pays \$220 to a commercial airline for flight from Washington to Chicago. This price includes the \$20.00 excise tax, stated separately on the ticket for which Frank is liable. The airline must collect this tax from Franklin and pay it to the government. A fine of up to \$100 may be imposed for failure to show the fare and tax separately on the ticket.

### 3. Inclusions.

Following are citations outlining what is to be included in the tax computation base:

- (a) IRC sections 4262(d) and 4272(d) state that the term "transportation" includes layover or waiting time and movement of aircraft in deadhead service. Deadhead service includes the return of an empty aircraft to its base of operation. Revenue Ruling 72-565, 1972-2 C.B. 578, states that taxable transportation includes nontransportation expenses of the pilot and crew with regard to layovers, including charges for salaries, lodging ground transportation, food, and entertainment.
- (b) Revenue Ruling 76-556, 1976-2 C.B. 354, states that hourly and flat rates, which include charges for layover time and movement of the aircraft in deadhead service, as well as for actual flight time, are subject to transportation tax.
- (c) Revenue Ruling 73-344, 1973-2 C.B. 365, concluded that state sales tax imposed on sellers of air transportation and passed on to their customer is part of amount paid for air transportation and is includible in determining the amount of transportation tax due.
- (d) Shell Oil Company v. United States, 79-2 USTC 16,322, states that transportation tax applies to both the hourly rate for actual use and the monthly charge guaranteeing availability of service. Congress didn't restrict tax to direct charges for aircraft flights that use public airports and airways.

### 4. "Free" Transportation.

Revenue Ruling 72-108, 1972-1 C.B. 346, concludes that the international departure tax applies to complimentary air transportation furnished solely to participants in package holidays in foreign resorts. The amount paid for these package holidays includes a charge for air transportation even though it may be advertised as "free".

5. **Military Personnel.**

Revenue Ruling 72-309, 1972-1 C.B. 348, concludes that 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.

D. **Leases.**

To determine whether lease payments are subject to 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 taxability of leases:

1. **Treas. Reg. Section 49.4261-7(h).**

It provides that an amount paid for the charter of an aircraft is subject to tax if the amount paid represents a per capita charge of more than 60 cents for each person actually transported, provided no charge is made to the persons transported. The charterer of an aircraft who sells transportation to other persons must collect and account for the tax on all amounts paid to it for transportation which are in excess of 60 cents. In that case, no tax is due on the amount paid for the charter of the aircraft; it is the duty of the owner of the aircraft to advise the charterer of its liability for collecting and accounting for the tax.

2. **Revenue Ruling 57-545, 1957-2 C.B. 749.**

It states that amounts paid by a company for the lease of an aircraft, including the operation and maintenance thereof, for transporting the company's personnel are subject to the tax imposed by IRC section 4261.

3. **Revenue Ruling 58-215, 1958-1 C.B. 439**

This ruling states that where a corporation owns an aircraft and appoints an airline company as its agent to service, maintain, overhaul, and operate the aircraft for the purpose of transporting the corporation's personnel, the airline company is not furnishing transportation services to the corporation and payments for the service provided are not taxable under IRC section 4261.

4. **Revenue Ruling 60-311, 1960-2 C.B. 341**

It states that the owner of an aircraft is furnishing taxable transportation if the owner:

- (a) Leases the aircraft with pilots to others for transportation of persons by air;
- (b) Retains elements of possession, command, and control of the aircraft; and
- (c) Performs all services in connection with the operation of the aircraft.

5. **Revenue Ruling 68-256, 1968-1 C.B. 489**

This ruling discusses the terms "wet lease" and "dry lease." Amounts paid for dry leases are not subject to transportation tax. A dry lease is indicated when the lessee furnishes its own crew or pilot and pays a lump sum for the lease. Under a dry lease, control is transferred to the lessee. Consequently, the payment is for a rental of the aircraft rather than a payment for taxable transportation.

A wet lease is indicated when the lessor includes crew and other services as part of the lease arrangement. Amounts paid for wet leases are generally subject to transportation tax because control of the aircraft remains with the lessor company because the lessor's crew is responsible for operations of the aircraft during the term of the lease. This is an important ruling.

6. **Revenue Ruling 70-325, 1970-1 C.B. 231.**

This ruling holds amounts paid by a sole shareholder to his or her corporation for aircraft flights are amounts paid for taxable transportation.

7. **Revenue Ruling 76-477, 1976-3 C.B. 329.**

It concludes that a contractor providing and controlling the pilots, maintenance, and fuel for helicopters provided to a federal agency is furnishing transportation services taxable under IRC section 4261 or 4271.

8. **Revenue Ruling 76-556, 1976-2 C.B. 354.**

It states that a company that rents helicopters with a pilot to customers for the transportation of employees to and from job sites is selling a taxable transportation service since the helicopter rental company retains possession, command, and control over the aircraft at all times.

**Caution:** The exemptions for certain helicopter uses contained in IRC sections 4261(e) and (f) were enacted after this revenue ruling.

9. **IRS Letter Ruling 7835009, May 25, 1978.**

Although it can't be used or cited as precedent, this ruling addresses whether fixed monthly payments under an aircraft lease agreements are considered taxable amount paid under IRC section 4261 and the criteria on which the determination is to be based.

10. **IRS Letter Ruling 7924007, February 27, 1979.**

Although it can't be used or cited as precedent, this ruling concludes that amounts paid by partners for flight services furnished by their partnership are subject to transportation tax.

11. IRS Letter Ruling 8148028, September 1, 1991.

Although it can't be used or cited as precedent, this ruling concludes that amounts paid by co-tenants for costs associated with the operation and ownership of aircraft owned as tenants in common are not subject to transportation tax.

E. State and Federal Government Agencies.

Amounts paid by state, local, and federal government entities are not exempt from the air transportation taxes imposed by IRC sections 4261 and 4271. See Revenue Ruling 76-477, discussed above in section VII. D.7.

1. IRC section 4292 provided an exemption for state and local governments from transportation and communication taxes. The exemption from section 205(a)(2) of the Airport and Airway Revenue Act of 1970.
2. There has never been a codified exemption from transportation tax for federal agencies.

Although it can't be used or cited as precedent, National Office Technical Advice Memorandum #9037002, May 23, 1990, addresses the unavailability of an exemption under IRC section 4293 for the United States and its possessions. It states that an airline company that contracted with a federal agency to fight forest fires was providing a taxable transportation service when carrying agency personnel or transporting property for the agency. The amount paid was, therefore, subject to the tax on transportation of persons and property by air.

The memo addresses the U.S. Treasury Secretary's Authorization dated March 31, 1967, exempting the Department of Interior from transportation taxes involving the presuppression or suppression of range and forest fires. It states that before 1970 the Secretary of the Treasury, under IRC section 4293, had the authority to exempt the United States and its possessions from the air transportation taxes. However, in 1970, Congress modified IRC section 4293 to remove the availability of a Secretary's Authorization for exemption from air transportation taxes. Therefore, with respect to air

transportation taxes, the Secretary's Authorization was revoked and has not been available to any federal agency since July 1, 1970.

F. **Audit Issues.**

The issues encountered most often in the air transportation area are as follows:

1. Items improperly excluded from the transportation tax computation base (such as, air charter companies not charging customers transportation tax on stand-by time, pilot expenses, and state sales tax).
2. Air charter companies exempting entities (which are not exempt) from transportation tax, such as federal and state governmental agencies.
3. Improper treatment of wet leases, discussed above in section VII. D.5.

VIII. **AIR TRANSPORTATION TAX AUDIT STEPS**

The following audit steps are recommended when examining reported air transportation tax:

- A. Reconcile total air transportation tax collected per books to the tax indicated on the Form 720 to verify that all tax collected has been remitted. Explain discrepancies.

Air transportation taxes are generally filed on Form 720 (Quarterly Federal Excise Tax Return) under the following IRS numbers:

1. IRS #26 - Transportation of Persons,
2. IRS #27 - Use of International Air Travel Facilities, and
3. IRS #28 - Transportation of Property.

**Caution:** See Treas. Reg. section 40.6302(c)-3(e) for rules for reporting taxes that were deposited under the alternative method.

- B. Reconcile air transportation tax as indicated on customer invoices to the tax recorded on the books to verify that all tax billed to customers has been correctly recorded on the books. Explain all discrepancies.

- C. Determine aircraft (by identification number) which have a maximum certificated take-off weight in excess of 6,000 pounds. Determine if a aircraft with maximum certificated take-off weight not in excess of 6,000 pounds are operated on an established line.
- D. Inspect air charter invoices for aircraft determined to weigh in excess of 6,000 pounds.
- E. Inspect flight log books to verify that all flight hours have been properly invoiced and that you have inspected all requested invoices.
- F. Verify from a sample of the requested invoices that the taxpayer is correctly computing the transportation tax due.
- G. Ask the taxpayer which entities or individuals, if any, that transportation tax is not being collected from. Inform taxpayer of the limited exemptions.
- H. Ask for any lease agreements for aircrafts weighing in excess of 6,000 pounds. Determine if the lease is a "wet" or "dry" lease, discussed above in section VII.D.5.

IX. **FUEL TAX CREDITS AND REFUNDS**

A. **IRC Sections 6421 and 6427 (1).**

Fuel tax credits and refunds under IRC sections 6421 and 6427 (1) may be allowed to the ultimate purchaser of the fuel only when:

1. Tax was imposed on the fuel, and
2. The fuel was used in a nontaxable use.

B. **Nontaxable Uses.**

Nontaxable uses and sales for uses of gasoline and aviation fuel include:

1. Use in certain helicopters.
2. Use on a farm for farming purposes.
3. Exclusive use of any state or local government.
4. Exclusive use of a nonprofit educational organization.

5. Use in military aircraft owned by the United States or a foreign country.
6. Use in a domestic air carrier engaged in foreign trade or trade between the United States and any of its possessions.
7. Use in a foreign air carrier engaged in foreign trade or trade between the United States and any of its possessions (but only if the country in which the foreign carrier is registered allows U.S. carriers reciprocal privileges). See Revenue Rulings 74-346, 1974-2 C.B. 361; 75-526, 1975-2 C.B.435; 75-398, 1975-2 C.B. 434; and 75-109, 1975-1 C.B.348, for a list of such countries.

C. **Determining the Amount of Credit.**

The amount of fuel tax credit claimed can be determined by obtaining copies of Form 843, Claim for Refund; Form 4136, Fuel Tax Credit (filed with income tax return); and Line 4 (Line 2 before first quarter of 1991) Adjustments taken on the Form 720. Blind credits are not authorized.

To determine the accuracy of the fuel tax credit claimed, multiply the total flight hours on which transportation tax is applicable by the average gallons of fuel burned per flight hour.

Remember that the Leaking Underground Storage Tank (LUST) tax of \$0.001 per gallon is not refundable for aircraft engaged in commercial aviation, unless the fuel has been used as supplies for aircraft engaged in international flights or military aircraft. See IRC section 6427 (1)(3).

D. **Claiming Credits or Refunds.**

Credits or refunds may be claimed by any of the following methods:

1. **Form 720, Line 4 Adjustment** (Line 2 before first quarter of 1991) - If a person is due a refund for taxes reported on the Form 720, it may claim a credit on Line 4 up to the amount of the total tax for the quarter. Persons should use Form 843 or Form 4136 to obtain any remaining refund or credit.

Blind Credit is not authorized nor indicated on the Form 720 as a separate line item. The charter company will deduct the amount of the fuel tax credit from taxes to be remitted and simply indicate the net tax due on the Form 720. This type of credit is evident if the total tax per books does not reconcile to the total tax as reported on the Form 720. Taxpayers using blind credits should be told that they are not authorized and that in the future a Line 4 adjustment must be made.

2. **Form 843** - A Claim for refund may be filed quarterly if the refund amount is at least \$1,000 per quarter for gasoline or special motor fuel, or at least \$750 for aviation fuel.

A special rule for aviation fuel allows taxpayers to aggregate the amount of fuel used in each quarter. If a taxpayer's claim is less than \$750 in a quarter, but the amount of the claim for more than one quarter is at least \$750; the taxpayer may file a claim for the quarter for which the combined total is at least \$750.

Taxpayers cannot file a quarterly claim for the fourth quarter of a tax year. Claims for the fourth quarter must be filed as a credit on the income tax return.

3. **Form 4136** - A fuel tax credit maybe be claimed on the income tax return.

**Note:** Make sure to verify that duplicate credits are not being claimed.

X. **EXAMINATION PROCEDURES OF COLLECTING AGENCIES**

IRC Section 6672 applies to the taxes imposed by IRC sections 4261 and 4271 and provides that any person (required to collect, account for, and pay over any tax) who willfully fails to collect it, account for it, or pay it over, or willfully attempts in any manner to evade or defeat it or its payment; is subject to a 100-percent penalty. Thus, airlines and charter companies can be held liable in such cases. See IRM 4741.

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Exhibit 1

Name	Examiner's Name
Address	Phone Number
	E:1201:EN
	Date

This letter is to confirm our appointment scheduled by telephone:

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DATE: September 26, 1991; Thursday

TIME: 8:00 a.m.

PLACE: Your place of business; please call to provide directions.

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Please have the following items available at the appointment:

1. Copies of Form 720 for the quarters ended 3/31/89, through the most current period; if any were filed.
2. Workpapers to reconcile the books to the Form 720.
3. A list including the certified take-off weights of all aircraft owned or leased during 1989, 1990, and 1991.
4. A list of any regularly scheduled routes flown during the years 1989, 1990, and 1991.
5. Books and records supporting air charter activities during the years 1989, 1990, and 1991.
6. Books and records supporting the sale or use of fuel in aircraft for the years 1989, 1990, and 1991.
7. Invoices to support these transaction for the 1990 year only.

Thank you for your cooperation.

Sincerely,

Examiner's Name  
Excise Tax Specialist

Enclosures:  
Publication 1  
Notice 609