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Tax Update: Private Aviation Cases

A Summary of Recent Noteworthy Decisions Regarding Taxation of Private Aircraft

NetJets Lands Partial Victory in Tax Row with IRS—The Fight Goes On

On January 26, 2015, a federal district court judge ruled on cross-motions for summary judgment that NetJets,[1] the operator of an aircraft fractional ownership program, was not required to collect federal excise tax (26 U.S.C. § 4261) on management fees and variable fuel costs charged to certain fractional program customers.[2]

The court determined that the IRS was barred from retroactively collecting excise tax on these fractional program charges since the IRS had previously issued NetJets' predecessor, Executive Jet Aviation, Inc. (EJA), a technical advice memorandum (TAM), in which the IRS agreed that NetJets was to collect excise tax only on fractional program "occupied hourly fees" (i.e., a per-hour flight fee for operating the aircraft).[3] The court held that the IRS is bound by the TAM, which had not been withdrawn, modified or revoked, and is therefore precluded from retroactively assessing excise tax on the management fees and variable fuel costs associated with NetJets' fractional program.

In the same decision, the court denied NetJets' claims for refund, finding that NetJets provides "taxable transportation" to its fractional program customers, and therefore properly charged and remitted excise tax on its occupied hourly fees. In reaching its decision, the court held that it was precluded from reaching a different result because of *Executive Jet Aviation, Inc. v. United States*, 125 F.3d 1463 (Fed. Cir. 1997), where it was determined that EJA provided "taxable transportation" under section 4261, and that its occupied hourly fees were subject to excise tax. According to the court, the EJA decision, which addressed the same issue raised by NetJets in its refund claims under substantially similar facts, is applicable to NetJets, which, as the successor to EJA, has privity to EJA and to the earlier decision.

On the issue of whether Executive Jet Management's (EJM) monthly management fees and other variable costs charged to the owners of aircraft that EJM manages and uses in its charter business are subject to excise tax, the court denied the parties' cross-motions for summary judgment. The court held that it could not reach a decision in summary judgment, since there were genuine issues of material fact as to the nature and extent of the services EJM provided to its customers. As a consequence, the court was unable to determine, from the limited evidence before it, who has "possession, command, and control" over the aircraft for purposes of determining whether excise tax applies to the monthly management fees or other variable costs that EJM charged to the aircrafts' owners.

Although the court could not reach a decision in summary judgment as to taxation of EJM's monthly management fees and variable costs charged to its customers, the court did make a number of potentially important findings. For instance, as a threshold matter, the court found that the IRS's "possession, command and control" test is the accepted test for determining whether an entity is providing "taxable transportation" under section 4261. The court also found that ownership alone does not determine whether an aircraft owner possesses, commands and controls its own aircraft. Additionally, the court noted that the IRS's test is not limited to the time the aircraft is actually in the air, and that a court must look beyond flight time to determine who has possession, command and control of the aircraft.

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1 NetJets Aviation, Inc., NetJets Large Aircraft, Inc. and NetJets International, Inc. (collectively, "NetJets").
2 *NetJets Large Aircraft, Inc. et al. v. United States*; No. 2:11-cv-1023 (S.D. Ohio 2015).
3 *See* Tech. Adv. Mem. No. 93-14-002 (Dec. 22, 1992); Private Ltr. Rul. No. 9314002, 12/22/1992.

Given that the court's decision is not a total victory for either NetJets or the IRS, either party (or both) may file an appeal of the court's summary judgment decisions. Presumably, EJM's case will move forward towards an eventual trial, if not otherwise resolved.

The impact of the NetJets decision has been largely mitigated by the fact that fractional program flights as of April 1, 2012 are subject to a fuel surtax in lieu of federal excise tax.[4] However, in view of the court's statements with respect to the EJM case, it may be a good time for aircraft owners to review their aircraft management contracts to determine whether they should be modified in order to clearly delineate which party has possession, command and control over the aircraft beyond just flight time.

Court Rules for IRS in Similar Bombardier Case

Shortly after the *NetJets* decision, a federal district court judge in Texas, on substantially the same issue, came down in favor of the IRS, finding that Bombardier Aerospace Corporation (Bombardier), in its operation of an aircraft fractional ownership program, did owe federal excise tax (26 U.S.C. § 4261) on management and variable fuel charge fees charged to its fractional program clients, and that (contrary to the court's decision in *NetJets*) Bombardier lacked standing to raise its claim for refund.

In *Bombardier Aerospace Corporation v. IRS*, No. 3:12-CV-1586-d (N.D. Texas 2015), the court held that: (i) Bombardier was providing "taxable transportation" under the IRS's "possession, command and control" test, (ii) FAA determinations and regulations as to what constitutes "transportation for hire" are not applicable to federal excise tax, (iii) the IRS had clearly informed Bombardier in a 2004 Technical Advice Memorandum (143115-03, Feb. 17, 2004) that its fractional fees *are* subject to excise tax, and (iv) such fees are part of Bombardier's taxable costs of transportation.

Additionally, the court held that Bombardier did not have standing to claim a refund for taxes paid by its fractional program customers, since Bombardier had not repaid the tax to its customers or obtained consent to claim a refund on their behalf.

The court distinguished the *NetJets* decision, which ruled in favor of NetJets based on estoppel, as there was no question in Bombardier's case that the IRS *had* informed Bombardier that its management fees *were* taxable. The court also disagreed with the *NetJets* court's decision on the issue of whether Bombardier had standing to claim a refund for excise taxes paid to the IRS, finding that "repayment" or "consent" were statutory preconditions for the court to have jurisdiction to entertain Bombardier's claim for refund for taxes collected from its clients.

American Helicopters, LLC et al. v. Ariz. Dep't of Revenue 1 CA-TX 14-0001 (Ct. of App. Jan. 29, 2015)

In *American Helicopters, LLC*, the Court of Appeals held that Papillon Airways, Inc. (Papillon), was subject to use tax on various aircraft parts it purchased for use in its business of providing on-demand and scheduled helicopter flights in Arizona and Southern Nevada. The court also held that Papillon's lessors, such as American Helicopters, LLC, were required to collect and remit Arizona transaction privilege tax (sales tax) on rental income earned from leasing helicopters to Papillon. In their collective defense, Papillon and its lessors argued that the aircraft parts and lease payments were exempt from Arizona sales and use tax under the state's "common carrier" exemption, which applies to the sale and leasing of:

> Aircraft, navigational and communication instruments and other accessories and related equipment sold to: A person holding a federal certificate of public convenience and necessity, a supplemental air carrier certificate under federal aviation regulations (14 Code of Federal Regulations part 121) or a foreign air carrier permit for air transportation for use as or in conjunction with or becoming a part of aircraft to be used to transport persons, property or United States mail in intrastate, interstate or foreign commerce.[5]
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> Ariz. Rev. Stat. Ann. 42-5061(B)(7)(a); 42-5071(B)(2)(b).

[4] As of April 1, 2012, qualified owner flights conducted pursuant to a fractional ownership program are subject to an additional fuel surtax of 14.1 cents per gallon. 26 U.S.C. § 4043(b).

[5] For purposes of the exemption, "Aircraft" includes "[t]angible personal property that is permanently affixed or attached as a component part of an aircraft that is owned or operated by a certificated or licensed carrier of persons or property." Ariz. Rev. Stat. Ann. 42-5061(W)(1).

The court found that the common carrier exemption was not applicable to Papillon and its lessors, since Papillon at the time did not hold a federal certificate of public convenience and necessity, and, as an on-demand Part 135 air carrier, Papillon did not satisfy the statutory requirement of being a "supplemental air carrier" under 14 C.F.R. Part 121.

Indiana Department of Revenue Letter of Finding No. 04-20140321, 01/01/2015

In Letter of Finding No. 04-20140321, the Department of Revenue determined that the owner and lessor of a claimed one-third interest in an aircraft did not qualify for Indiana's purchase for resale (lease) exemption, even though the owner/lessor was remitting Indiana sales tax on the lease payments received for rentals of the aircraft, because the owner/lessor did not provide sufficient evidence to establish: (i) that it was "occupationally engaged" in the business of leasing aircraft (e.g., insurance policies, flight logs, invoices, etc.) and (ii) that it met the minimum revenue threshold to claim a resale exemption for aircraft acquired to lease in Indiana, which requires annual gross lease revenue from the business of leasing aircraft to be equal to or greater than 7.5% of the aircraft's book value or net acquisition price (*see* Ind. Code 6-2.5-5-8(e)).

Texas Comptroller's Decision No. 106,522, 11/26/2014

In Texas Comptroller's Decision No. 106,522, the Comptroller affirmed an administrative law judge's decision, which found that: (1) an aircraft owner "used" the aircraft in Texas by entering into a charter agreement with a Texas Part 135 carrier; (2) the aircraft was not purchased to lease in the regular course of business (and was therefore not exempt from use tax as a "sale for resale") because the lease agreement was really an aircraft service agreement and the aircraft was used mostly in owner-operated flights; and (3) the state's common carrier exemption (Tex. Tax Code 151.328(a)(1)) did not apply since the aircraft's owner/lessor is not itself a certificated air carrier.

If you have any questions regarding these decisions, federal or state taxes with respect to aircraft, or Federal Aviation Administration rules and procedures, please contact the authors of this bulletin or any Vedder Price attorneys with whom you regularly work.

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