

FEDERAL EXCISE TAXES

Nel Stubbs

When dealing with the application of the Federal excise taxes to any aviation activity, you need to consider not only how the Federal Aviation Administration (FAA) defines the activity, but also how the Internal Revenue Service (IRS) views it as well. The majority of the confusion about how the taxes apply stems from how the FAA and the IRS look at identical situations and/or operations. First, there is the issue of whether an operation is commercial, and then the issue of operational control versus possession, command and control.

When first determining whether an operation is commercial or noncommercial for Federal tax purposes, it must be noted that the FAA and the IRS do not necessarily agree on what constitutes a commercial operator or operation. The FAA defines a commercial operator as a "person who, for compensation or hire, engages in the carriage by aircraft in air commerce of persons or property." To test whether an operation is for "compensation or hire," you must first determine if the carriage by air is merely incidental to the person's other business or is, in itself, a major enterprise for profit. (FAR 1.1) The IRS defines a commercial operator as "anyone in the business of transporting persons or property for compensation or hire by air" - profit is not a consideration. [(IRC 4041(c))]

Although these two definitions may sound very similar, the FAA is primarily concerned with safety, and the IRS is concerned with economics. In fact, the IRS has a Revenue Ruling which states that the FAA's definition of commercial aviation is not determinative in deciding which tax applies. (IRS Revenue Ruling 78-75)

Secondly, when determining which tax applies in any particular situation, there is the concern of who is in control of the aircraft. The FAA uses the phrase "operational control," which translates as the "exercise of authority over initiating, conducting and terminating a flight." (FAR 1.1) However, the IRS determines who has "possession, command and control" by using the following criteria:

- Who owns the aircraft,
- Who has control over the aircraft's personnel,
- Who pays the operating expenses of the aircraft, and
- Who maintains the liability and risk insurance for the aircraft? (IRS Revenue Ruling 58-215)

Based on these criteria, one can conclude who has possession, command and control of the aircraft to determine if the transportation is taxable. An example of this would be a company that hires an aircraft management company to manage, maintain, and provide pilot services for the aircraft. The owning company, through various means, still maintains possession, command and control over the operation of the aircraft. Therefore, the flights flown for the owner are not subject to the commercial transportation tax.

So why is there such confusion as to which operations are subject to the commercial Federal excise tax? One reason is the FARs allow certain noncommercial (Part 91) operators to receive some compensation for flights conducted under Federal Aviation Regulation (FAR) 91.501 Subpart F as long as the operation is incidental to the business of the company. These operations include time-sharing, interchange, and demonstration flights. These operations are considered noncommercial to the FAA. However, the IRS does not distinguish between operations that are "merely incidental" and those that are a

“major enterprise for profit.” If an aircraft is provided to any entity and compensation is received, it is considered commercial for Federal excise tax purposes, unless an exemption applies.

This brings us to “What does the commercial FET apply to?” It applies to all the amounts paid, including deadhead or repositioning flights, crew expenses, crew salaries, layover time, state taxes, etc. However, catering, flight phones, and limousine services obtained for the customer are exempt from the commercial excise tax, as long as it is separately stated on the invoice. In the case of an interchange, an arrangement whereby a person leases his airplane to another person in exchange for equal time, when needed, on the other person’s airplane and no charge, assessment or fee is made, except that a charge may be made not to exceed the difference between the cost of owning, operating and maintaining the two airplanes, the tax is due on the fair market value of time exchanged. Mind you, there are two fair market values in life, yours and the IRSs. Your best bet is to apply the tax to your fair market value and not wait for the IRS to do it for you.

What are the different tax rates between the non-commercial and the commercial Federal Excise Tax (FET)? The non-commercial FET is a fuel tax that is applied and paid for at the place of purchase, the pump. If you are considered a non-commercial operator for FET purposes, then you have paid your taxes. The fuel tax rates are as follows:

However, these Federal Excise Taxes (“FET”) are made up of several components that will be reviewed below. These are the rates that are effective January 1, 2025.

The *noncommercial* Federal Excise Taxes are the fuel taxes:

- **Aviation Gasoline (Avgas)**
 - \$0.15 per gallon excise tax
 - \$0.043 per gallon Deficit Reduction Tax
 - \$0.001 per gallon LUST tax
 - **\$0.194 per gallon - TOTAL**
- **Jet Fuel (Jet A)**
 - \$0.175 per gallon excise tax
 - \$0.043 per gallon Deficit Reduction Tax
 - \$0.025 per gallon “fuel fraud” tax¹
 - \$0.001 per gallon LUST tax
 - **\$0.244 per gallon – TOTAL**

The *commercial* Federal Excise Taxes are broken into two categories: 1) Transportation of Persons, and 2) Transportation of Property, with the Transportation of Persons being broken down into two more categories, 1) Domestic, and 2) International.

- **TRANSPORTATION OF PERSONS**
 - **Domestic**
 - Excise Tax
 - 7.5% on the amounts paid
 - This tax is due on all amounts paid except for catering, baggage handling, flight phones, and limousine services for the passengers.
 - Segment fee
 - **\$5.20 per person, per leg** (this fee can change every January)

¹ The 2005 Highway Bill changed how aviation jet fuel was to be taxed. While the aviation fuel tax rate remained the same, \$0.219 per gallon, most fuel leaving refineries has a \$0.244 per gallon rate, which now requires users to obtain a refund for the \$0.025 per gallon difference.

- The segment fee does not apply to
 - Flights to and from rural airports
 - A rural airport is an airport with less than 100,000 enplanements and greater than 75 miles from such airport.
 - Airports that are not connected by paved roads to another airport.
 - **International**
 - Departure & Arrival Fees
 - **\$22.90 per person** departure from the US and **\$22.90 per person** arrival in the US.
 - An international flight is a flight that does not begin and end in the United States, or in the '225-mile zone', or is considered 'uninterrupted' international air transportation." The "225-mile zone" is that portion of Canada and Mexico that is not more than 225 miles from the nearest point in the continental United States. The term "uninterrupted international air transportation" means that if a scheduled international flight takes off from a city in the United States, lands in another U.S. city, and has a layover of less than 12 hours, it is considered uninterrupted international air transportation. If a flight is considered uninterrupted international air transportation or it goes outside the 225-mile zone, the 7.5 percent commercial transportation tax is *not* owed, and the \$18.00 per person, departure and arrival, head tax does apply.
 - Alaska and Hawaii
 - For departures from Alaska and Hawaii and the continental US, the tax is **\$11.40 per person**.
 - Note that this fee is only for departures from Alaska and Hawaii, and the domestic transportation of persons' tax applies to the portion of the flight that is over US water or land.
- **TRANSPORTATION OF PROPERTY**
 - **6.25% is imposed on the cargo waybill for flights within the United States**

If you are considered a commercial operator for purposes of FET and are required to collect and remit the commercial FET and you may be entitled to a refund or credit of the excise tax paid on the fuel burned in that commercial activity. The Federal Excise Taxes are mutually exclusive; you either pay one or the other, never both, but there are times when you may be exempt from both the non-commercial and the commercial FET.

However, all is not lost; if you are considered a commercial operator for purposes of the FET, you may fall under one of the exemptions from the commercial tax. Always remember that all exemptions are narrow and you should consult with a tax professional to ensure that your operation will fall under a particular exemption. Also, be aware that if you are exempt from the transportation of a person's tax, you may be subject to the fuel tax. The following are some of these exemptions:

- **AIRCRAFT THAT WEIGH LESS THAN 6,000 POUNDS**
 - Aircraft that weigh less than 6,000 pounds and *are not* operated on an established line are exempt from the commercial FET, fuel tax applies.
 - This exemption does not apply to jets.
 - Sightseeing Flights – "...a small aircraft is not considered as being operated on an established line at any time during which the aircraft is being operated on a flight the sole purpose of which is sightseeing" are exempt from the commercial FET, fuel tax applies.
- **FORESTRY & LOGGING OPERATIONS**
 - Fixed Wing & Helicopter engaged in forestry or logging operations are exempt from the commercial FET and fuel taxes as long as the aircraft does not use a facility that receives AIP funding.
- **FIREFIGHTING**

- Firefighting protection service involving the dispersing of fire retardant, forest fire spotting, aerial firefighting protection, etc., is exempt from the commercial FET, fuel tax applies.
 - However, carrying persons for hire to fight the fire is not exempt from the commercial FET.
- **OIL EXPLORATION**
 - Helicopters engaged in the exploration or development of hard minerals, oil, or gas are exempt from the commercial FET and fuel taxes as long as the aircraft does not use a facility that receives AIP funding.
- **EMERGENCY MEDICAL FLIGHTS**
 - Helicopters engaged in emergency medical flights and fixed-wing aircraft that are equipped for and exclusively dedicated on that flight to acute care emergency medical services are exempt from both the commercial FET and the fuel taxes.
- **MEMBERS OF AN AFFILIATED GROUP**
 - If your aircraft operates within an affiliated group (a group made up of a parent company owning 80% or more of subsidiary companies), then the flights within the affiliated group are exempt from the commercial FET, fuel tax applies.
- **SKYDIVING**
 - Amounts paid by skydivers to be taken to a point in the sky to jump out of an airplane are exempt from the commercial FET, fuel tax applies.
- **SEAPLANES**
 - Any flight segment consisting of a take-off and a landing on water is exempt from the commercial FET, fuel tax applies.
- **OTHER EXEMPTIONS**
 - **Fuel FET Exemptions**
 - Fuel sold for use in farming
 - Aircraft Museums
 - For exclusive use by any State or political subdivision
 - Sale for export
 - **Commercial FET Exemptions**
 - Caretakers and messengers accompanying freight shipments
 - Circus or show conveyances
 - Corpses

So, when doing tax planning for the application of Federal excise taxes, you need to know how the aircraft is going to be used, who is going to be using the aircraft, and whether or not any of the applicable exemptions apply.

A good example of this would be the transportation of organs for transplant. Examining all the rules...the transportation of an organ for transplant is considered to be transportation of property, and the person accompanying it is the transportation of persons. However, there is an exemption now for emergency medical flights for both helicopters and fixed-wing aircraft. So, if this flight fell under the definition of an emergency medical flight, then there would be no commercial or non-commercial tax applied to that flight [IRC 4261(g)]. However, if this flight does not fall under this definition, then the value of the transportation of the person(s) accompanying the freight would not be subject to tax [26CFR4261-8(b)], but the transportation of the property would be.

International Flights

What would be considered an International Flight? The Internal Revenue Service defines an International Flight as, "A flight that does not begin and end in the United States, or in the '225-mile zone', or is considered 'uninterrupted' international air transportation." The "225-mile zone" is that portion of Canada and Mexico that is not more than 225 miles from the nearest point in the continental United States. The term "uninterrupted international air transportation" means that if a scheduled international flight takes off from a city in the United States, lands in another U.S. city, and has a layover of less than 12 hours, it is considered uninterrupted international air transportation. If a flight is considered uninterrupted international air

Abingdon, VA 24210

nel@stubbsaviationadvisors.com

(602) 791-3824

transportation or it goes outside the 225-mile zone, the commercial transportation tax is *not* owed, and the \$16.70 (2012) per person, departure and arrival, head tax does apply. Regarding Alaska and Hawaii, there is a \$8.40 (2012) per person departure tax only, however, the domestic transportation tax applies to a portion of the flight.

Example 1: A charters an aircraft in Washington, DC for travel to Tijuana, Mexico.

Since Tijuana is within 225 miles of the continental United States, this flight is not considered an international flight; therefore, the domestic 7.5 percent tax and segment fee is due.

Example 2: A charters an aircraft for travel from Wichita, KS to Edmonton, Canada.

Since Edmonton is more than 225 miles from the U.S. border, this is considered an international flight, and the \$16.70 per person departure and arrival tax is due.

Example 3: A charters an aircraft in New York for transportation from New York to Nassau, with a scheduled stop in Miami on both the outbound and return trip.

The \$16.70 per person departure and arrival tax is due because the trip was uninterrupted (i.e., the layover in Miami was for less than 12 hours), and Nassau is not in Canada or Mexico; therefore, the 225-mile rule does not apply.

Example 4: A charters an aircraft from San Francisco to London with stopovers in Denver, Chicago, Philadelphia, and New York. The stopover at Denver and Chicago is less than 12 hours. However, after arriving in Philadelphia, A, for his own convenience, decides to layover for more than 12 hours.

The total amount paid by A for this charter from San Francisco to New York is subject to the domestic transportation tax, since one of the stopovers exceeded 12 hours, and the international departure and arrival taxes will be due as well. If the carrier, for its own convenience, such as repairs, extends the stopover in Philadelphia to more than 12 hours, then the domestic portion of the flight will not be subject to the domestic tax, and only the international departure and arrival taxes will be due.

Example 6: A charters an aircraft for roundtrip from San Francisco, CA to Honolulu, HI.

In this case, both the domestic and the international tax will apply. The portion of the transportation that is outside the continental U.S. and outside Hawaii is excluded from the application of the domestic tax. However, domestic tax does apply to the portion of the transportation that is between the airport in San Francisco and the three-mile limit off the coast of California (15 miles) and between the three-mile limit off the coast of Hawaii and the airport in Honolulu (5 miles). To do this calculation, you will need to know the following:

Total Miles for Trip		9909	SM
Domestic Miles			
Distance from Starting Point to 3 miles off the United States Coast		2041	SM
Distance from 3 miles of the coast to destination in HI		5	SM
Distance from city in HI to 3 miles off the coast		5	SM
Distance from 3 miles of the coast to destination continental US	#	2041	SM
Total Domestic Nautical Miles		4092	SM
Total Amount Paid for Trip (landing fees, etc, minus...)		\$100,000.00	

Total Amount Subject to the domestic FET (7.5%)		\$41,295.79	\$3,097.18
Number of Passengers		9	
Hawaii Departure Tax for 2016		\$11.40	\$102.60
Segment Fee for 2016		\$5.20	\$46.80
TOTAL FET DUE			\$3,246.58

This is a synopsis of the application of the Federal Excise Taxes. As with any tax, an aircraft owner or operator should consult with an entity that understands how these rules can be applied. Most of the rules and regulations governing the application of the commercial FET have not changed much since the 1950's. However, new IRS interpretations and guidance have given cause to a vigorous effort by the IRS to audit general aviation aircraft.