

IRS Hot Topics

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FAA Modernization and Reform Act of 2012 adds surtax for fuel used in fractional ownership programs

On February 14, 2012, President Obama signed the FAA Modernization and Reform Act of 2012 (the Act), which creates IRC Section 4043 that imposes a new 14.1¢ per gallon surtax on general aviation jet fuel purchased and used in certain fractionally owned aircraft. In addition, the Act extends existing provisions, set to expire February 17, 2012, in the Internal Revenue Code that fund the Airport and Airway Trust Fund and related taxes through September 30, 2015. The amended provisions became effective on February 18, 2012, allowing for a seamless extension.

New Section 4043, surtax on fuel used in aircraft part of a fractional ownership program

Previously, fractional ownership aircraft flights, now subject to the new surtax, were treated as commercial aviation for purposes of federal excise tax. Accordingly, such domestic flights of persons were subject to the air transportation tax pursuant to Section 4261, i.e., the ad valorem tax of 7.5% of the amount paid for the transportation of persons¹ and a \$3.80 segment tax, and an additional 4.4¢ per gallon (including LUST) tax on aviation kerosene.²



¹ Transportation of property is subject to Section 4271. Collectively, Sections 4261 and 4271 are referred to as air transportation excise taxes.

² If the aircraft operated on aviation gasoline, the fuel excise tax was a different amount.

Beginning April 1, 2012 and through September 30, 2015, fuel used in 'fractional aircraft program' aircraft for the transportation of, or on account of, a qualified fractional owner will be considered non-commercial aviation and, therefore, exempt from air transportation excise taxes and the 4.4¢ per gallon tax on fuel used in commercial aviation. Instead, these flights will be subject to the existing base fuel tax for fuel used in non-commercial aviation (21.9¢ per gallon, including LUST) and the new fuel surtax. The additional fuel surtax of 14.1¢ per gallon will apply to fuel used in a fractional program aircraft for the transportation of a qualified fractional owner with respect to the fractional ownership aircraft program of which such aircraft is a part and with respect to the use of such aircraft on the account of such a qualified fractional owner. Section 4043(a) and (b) (emphasis added); see also H.R. 658, 112th Cong. (2012); H.R. Rep. No. 112-381, at 139-42 and 279-81 (2012) (Conf. Rep.).

A fractional ownership aircraft program is a program whereby: (1) a single fractional ownership program manager provides fractional ownership program management services on behalf of the fractional owners; (2) there are one or more fractional owners per fractional program aircraft, with at least one fractional program aircraft having more than one owner; (3) with respect to at least two fractional program aircraft, none of the ownership interests in such aircraft can be less than the minimum fractional ownership interest, or held by the program manager; (4) there exists a dry-lease aircraft exchange arrangement among all of the

fractional owners; and (5) there are multi-year program agreements covering the fractional ownership, fractional ownership program management services, and dry-lease aircraft exchange aspects of the program. Section 4043(c)(2). The term 'dry-lease aircraft exchange' is defined as an agreement, documented by the written program agreements, under which the fractional program aircraft is available on an 'as needed basis' without crew to each fractional owner. Section 4043(c)(4). The definition of a fractional program aircraft is any aircraft which is listed as a fractional program aircraft in the management specifications issued to the manager of such program by the Federal Aviation Administration under subpart K of part 91 of Title 14, Code of Federal Regulations and is registered in the United States. Section 4043(c)(1).

The term 'qualified fractional owner' means any fractional owner that has a minimum fractional ownership interest in at least one fractional program aircraft. Section 4043(c)(3)(A). The term 'minimum fractional ownership interest' is applied with respect to each aircraft and means: (1) a fractional ownership interest equal to or greater than one-sixteenth (1/16) of at least one subsonic, fixed wing or powered lift aircraft; or (2) a fractional ownership interest equal to or greater than one-thirty-second (1/32) of at least one rotorcraft aircraft. Section 4043(c)(3)(B). A 'fractional ownership interest' is the: (1) ownership interest in a program aircraft; (2) holding of a multi-year leasehold interest in a fractional program aircraft; or (3) holding of a multi-year leasehold interest that is convertible into an

ownership interest in a fractional program aircraft. Section 4043(c)(3)(C). A 'fractional owner' is a person owning any interest in a fractional program aircraft, including the entire interest. Section 4043(c)(3)(D).

Flight demonstrations, maintenance, and crew training by a fractional program aircraft are excluded from the fuel surtax, but will be subject to the non-commercial aviation fuel tax. Section 4043(c)(5); H.R. Rep. No. 112-381, at 141, 280 (2012) (Conf. Rep.). Further, if a prospective purchaser pays any amount for transportation for a demonstration flight, that flight will be subject to Sections 4261 or 4271 air transportation excise taxes and not treated as non-commercial aviation. See H.R. Rep. No. 112-381, at 280, fn. 34 (2012) (Conf. Rep.).

Section 4043 sunsets on September 30, 2021, but the exemption from air transportation excise tax for aircraft in fractional ownership aircraft programs is only in effect until September 30, 2015. This means that on October 1, 2015, the exemption from air transportation excise taxes for aircraft in fractional ownership aircraft programs will have expired and, without extension of the exemption, such aircraft will be subject to the air transportation excise taxes in addition to the fuel surtax and base fuel taxes.

Extension of existing provisions

The Act also extends the current air transportation excise tax provisions imposing tax on amounts paid for

commercial air passenger and freight transportation and on fuels used in commercial aviation and non-commercial aviation to fund the Airport and Airway Trust Fund through September 30, 2015. The 4.3¢ per gallon fuel tax (exclusive of LUST) on commercial aviation under Section 4081 is permanent and therefore, not extended as part of the Act.

Sections extended through September 30, 2015

- Domestic air passengers. Section 4261(a) and (b) imposes a 7.5% tax on the amount paid for the taxable transportation of any person plus \$3.80³ on transportation that begins and ends in the US or within the 225-mile zone of the US (note, special rules apply for flights to-and-from Alaska/Hawaii).
- International travel facilities tax. Section 4261(c) imposes a \$16.70 per arrival or departure tax for use of international travel facilities.⁴
- Amount paid for right to award free or reduced rate passenger air transportation. Section 4261(e)(3) imposes a 7.5% tax on the amount paid for the right to award free or reduced rate passenger air transportation (i.e., frequent flyer mile programs).
- Air cargo (freight) transportation. Section 4271 imposes a 6.25% tax on the amount charged for domestic transportation (no tax is imposed on international cargo transportation).
- Aviation fuels. Section 4081(a)(2)(A)(ii) imposes a 19.3¢ per gallon tax on non-commercial

³ This amount includes the 2012 annual adjustment for inflation.

⁴ See fn. 3, *supra*.

(general) aviation gasoline. Section 4081(a)(2)(C)(ii) imposes a 21.8¢ per gallon tax on non-commercial (general) aviation jet fuel. Section 4081(a)(2)(B) imposes an additional 0.1¢ per gallon excise tax on both of the above amounts to fund the Leaking Underground Storage Tank Trust Fund. In addition, the .01¢ per gallon excise tax is also imposed on the permanent 4.3¢ per gallon tax on commercial aviation fuel (kerosene or aviation gasoline) pursuant to Section 4081(a)(2)(C)(i).

PwC observations

Since September 2007, and prior to enactment of the Act, the air transportation excise taxes had been extended approximately 20 times, all on a short-term basis. The Act allows for a few years of certainty, rather than a few months of certainty.

This Act provides clarity for fractional flights covered by Section 4043, specifically that fuel excise taxes apply and air transportation excise taxes will

not apply, however, uncertainty remains, as of now, with respect to the period after September 30, 2015. Previously, there were frequent disputes between taxpayers and the IRS as to whether air transportation excise taxes applied to fractional ownership flights and what amounts were amounts paid for taxable transportation. This Act, in part, alleviates many of the prior disputes.

Absent future action, the air transportation excise tax and fuel excise surtax will apply to fractional flights covered by Section 4043 after September 30, 2015, and before, September 30, 2021. We expect future discourse to address this disparity, but there remains uncertainty concerning what action will be taken and when. This is important to consider in the context of long-term leasing interests and arrangements in fractional ownership aircraft and participating in a fractional ownership programs through agreements extending beyond September 30, 2015.

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