



FOR IMMEDIATE RELEASE

29 June 2012

Contact: C. Joy Journey, Executive Director

Alaska Air Carriers Association

joy@alaskaaircarriers.org (907) 277-0071

AACA Challenges IRS Interpretations and Penalties for the Collection of Aviation Excise Taxes

THE REGULATION

The wording of the regulation can be found in IRS Publication 510 – Excise Taxes, Pages 30-32 (Chapter 4).

BACKGROUND

Both private and commercial business aircraft operators pay federal excise taxes (FET) either on fuel or on the transportation of persons or property. In most cases, private operators (Part 91) are subject to the fuel tax on non-commercial aviation. Commercial operators (Part 135) are subject to the tax on transportation of persons or property.

For commercial transportation, FET takes the form of a percentage tax or a head tax, or both. The traditional FET is a percentage tax on the amount paid for commercial transportation. There is also a segment fee due on each domestic segment. Finally, a head tax also applies to international transportation of persons.

For non-commercial transportation, the fuel tax is a cents-per-gallon tax with different rates for both aviation gasoline and jet fuel. In most cases, this tax only applies to non-commercial transportation. Note that when tax-paid fuel is used in commercial transportation, the purchaser can claim a refund less a small portion of the tax.

It is important to note that the Internal Revenue Service (IRS) and Federal Aviation Administration (FAA) have different views on what constitutes commercial and non-commercial operations. In certain cases, an operation that is viewed as non-commercial by the FAA may actually be viewed as commercial by the IRS for FET purposes.

Effective January 1, 2012, the excise taxes due on commercial air transportation are:

Percentage Tax	7.5%
Domestic Segment Fee	\$3.80
Hawaii/Alaska Flight Tax	\$8.40

ISSUE

To quote one of AACAA’s articulate members, “The IRS is engaging in predatory collection practices as it targets small Alaska air taxi companies. Making use of broad over reaching interpretations of ambiguous Federal Excise Tax regulations, the IRS engages in intimidation and threats to extract alleged back taxes from struggling operators with limited resources.”

For almost fifty years, there has been no indication or finding from the IRS towards aviation companies that passenger or freight FET applies to activities seen by operators as outside the intent of the regulation. Three realities appear to contribute to the current escalation of this issue.

First, much confusion exists in the business aviation community over the application of the excise tax rules caused by terminology differences between the IRS (the agency that imposes the tax and administers to the rules) on the one hand and the FAA on the other hand. Operators, especially commercial operators, are often times more familiar with the FAA rules and definitions than they are with the IRS rules and definitions.

Second, current economic conditions have caused the federal government to look for opportunities to extract sorely needed funding.

Third, multiple ambiguous aspects of the excise tax, and grossly inappropriate IRS interpretations, are creating not only confusion in the industry, but dynamically threaten the ability of businesses to comply. The regulation is confusing and interpreted in multiple ways by IRS auditors.

- “An established line” is defined in the regulation as that which “the aircraft operates with some degree of regularity between definite points.” This not measurable and is interpreted inconsistently.
- The IRS actually takes the position that a flight that begins and ends at the same point (sightseeing) is a flight that is between different points, and subject to FET.
- The IRS has argued against granting the exemption to sightseeing operators on the basis that the exemption was to apply to air taxi operators flying short flights to various destinations; however, when the IRS examines an air taxi operator that meets what the IRS previously argued is exempt, the IRS then revises its position to impose the tax.
- In Alaska over 85% of the aircraft qualify under the small aircraft exemption and serve a flight area of over three million square mountainous miles. Flight routes are determined by topography: all routes are taken with “some degree of regularity.”
- IRS auditors do not use and adhere to the test contained in the regulation to determine what qualifies as “an established line on a charter basis,” which is that it is “between two cities also served by that carrier on a regularly

scheduled basis. A large portion of flights in Alaska are chartered to homes and small business. IRS administrative rulings, federal court decisions and other tests have been developed to determine when an operator has operations on an established line and when air transportation excise tax applies. In nearly every published case over the last 25 years, the existing record has allowed judges to find for the taxpayer, yet the IRS continues to ignore the factors and tests set forth by the court and in administrative decisions.

- Selling seat fares to utilize a charter customer's left-over capacity, thus maximizing capacity utilization to the benefit of all (school districts, native health providers, etc.) is interpreted by the IRS as "scheduled flying" even though the initiation, timing and complete itinerary of the flights are controlled by the initial charter customer.
- Flights "solely for flight-seeing" are excluded, yet much of Alaska's flight-seeing involves a touchdown so that visitors can experience a glacier or view wildlife. These flights with brief touchdowns are misinterpreted by some IRS agents as being subject to the excise tax.
- Currently a gravel bar or lake is the same for tax purposes as a major airport. The "rural airport" exemption to the segment tax must be changed to include any location that is not a "major airport".
- A large portion of the flights within the State of Alaska are seasonal in nature. IRS has concluded that destinations are on an established line because, throughout the months of summer (May through September) destinations are serviced with "regularity." It matters not that planes don't go there at all for the remainder of the year.
- Seaplanes (float planes) are exempted for segments to and from places "not receiving financial assistance from the Airport and Airways Trust Fund." Yet, small carriers are being penalized by auditors.

CHALLENGES

For both the FAR Part 91 operator and the FAR Part 135 certificated operation, the lack of in depth federal excise tax knowledge can be costly. Many flights under Part 91 are subject to federal excise tax and have also now become an IRS enforcement emphasis.

Hopefully it will be possible to reach a consistent standard as the shifting position of the IRS makes it impossible to determine when flights are taxable. For example,

Multiple commercial carriers, who methodically and conscientiously collect FET, have just finished, or are in the midst of, audits and are being fined amounts in the range of \$1.8 million to \$250,000. And they fly the small planes supposedly "exempt." From auditor comments to the carriers, it appears that Alaskan aviation companies are targets for future audits.

Although experience shows that ninety percent of all challenges on aviation excise taxes are overturned in court, the IRS threat to Alaska carriers is that if they challenge current three-year audit findings, the IRS will come back for a full seven-year audit. The three year audits already take an extensive time and staff commitment for weeks and months for these small businesses. In addition, the IRS appears to be targeting these audits specifically in the busy summer flying season—suspiciously coinciding with good fishing and travel opportunities for visiting auditors, and during high hotel cost periods.

The financial and staff time burden imposed on small businesses to undergo an IRS audit is substantial. Extensive documentation is demanded from the businesses, yet the IRS provides no documents to substantiate their claim in writing, so there is no citation of tax code, case law, or anything else to back their claims against the targeted businesses.

RECOMMENDATIONS FOR RESOLUTION

- As U.S. citizens, we are entitled to clarity and transparency in all matters of regulatory compliance. Recommendations:
- 1) For complete clarity and maximum compliance, change IRS language regarding FET applicability to conform to FAA Air Carrier classifications, i.e., Part 135 Scheduled and Part 121 operators pay passenger/freight/segment FET for their scheduled operations. Part 91 and Part 135 Non-Scheduled operations are exempted (but instead pay fuel FET). The nebulous terms "established line" should be eliminated in favor of the unequivocal "scheduled" or "non-scheduled". This would eliminate the troublesome and undefined language that specifies that "established line" must satisfy (a) operated with some degree of regularity, (b) between definite points and (c) the operator exercises sufficient control over the flight.
 - 2) In recognition of our dependence on air travel and the special utility of larger aircraft in the State of Alaska, raise the weight limit ceiling of the "small aircraft exemption" from the present limit of 6,000 lb. to the former limit of 12,500 lb. Since everyone must, by and large, travel significant distances by air in Alaska, aircraft are naturally larger here to accommodate this volume. The nature of the travel is the same as for an under 6,000 lb. aircraft, just scaled up out of necessity.
 - 3) Eliminate the "airport funding" exception from the "seaplane exemption" as being unnecessarily complicated and difficult to administer and comply.
 - 4) Change the "rural airport" exemption to the segment tax to include any location that is not a "major airport". Currently a gravel bar or lake is the same for tax purposes as a major airport.

AACA INVOLVEMENT

Appeals to the IRS: AACA has demanded a precise interpretation of the measurements, terms, and definitions in the IRS regulation from the IRS Commissioner, Douglas Shulman. A “non-answer” letter was received from the Washington DC IRS offices.

Appeals to the Taxpayer Advocate Service via their electronic submission system. To date no acknowledgement or answer has been received.

Appeals to our federal delegation and state government: AACA has kept our federal delegation and state government (Senator Mark Begich, Senator Lisa Murkowski, Congressman Don Young, and Governor Sean Parnell) apprised of the issue and copied on the IRS appeals and responses and those of our members.

WHERE WE ARE TODAY

Alaska’s delegation and their staff have tirelessly contributed time to meetings and fact finding on the issue. Meetings have been held with both Finance and Commerce committees and staff. Senator Begich and Congressman Young sent letters to the IRS on this issue, with no resolution. Senator Begich recently released his letter demanding a meeting with the Secretary of the Treasury, Timothy Geithner.

~~~~~

Since 1966 the Alaska Air Carriers Association (AACA) has represented the interests of aviation businesses in Alaska. Our 150 members own, operate, and service aircraft, providing for the needs of the traveling public through scheduled commuter operations, aircraft maintenance, flight tours, on-demand air charters, fuel sales, parts sales, storage, rental, airline servicing, flight training, and emergency medical evacuation.

Information about the association can be found at [www.alaskaaircarriers.org](http://www.alaskaaircarriers.org).