



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 40 and 49

[REG-112042-19]

RIN 1545-BP37

Excise Taxes; Transportation of Persons by Air; Transportation of Property by Air;
Aircraft Management Services

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and partial withdrawal of notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the excise taxes imposed on certain amounts paid for transportation of persons and property by air. Specifically, the proposed regulations relate to the exemption for amounts paid for certain aircraft management services. The proposed regulations also amend, revise, redesignate, and remove provisions of existing regulations that are out-of-date or obsolete and generally update the existing regulations to incorporate statutory changes, case law, and other published guidance. In addition, the proposed regulations withdraw a provision that was included in a prior notice of proposed rulemaking that was never finalized and re-propose it. The proposed regulations affect persons that provide air transportation of persons and property, and persons that pay for those services.

DATES: Written or electronic comments and requests for a public hearing must be received by **[INSERT DATE 60 DAYS AFTER PUBLICATION OF THIS DOCUMENT]**

IN THE FEDERAL REGISTER]. Requests for a public hearing must be submitted as prescribed in the “**Comments and Requests for a Public Hearing**” section.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-112042-19) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The IRS expects to have limited personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment submitted electronically, and to the extent practicable on paper, to its public docket.

Send paper submissions to: CC:PA:LPD:PR (REG-112042-19), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, D.C. 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Michael H. Beker or Rachel S. Smith at (202) 317-6855; concerning submissions of comments and/or requests for a public hearing, Regina Johnson, (202) 317-5177 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Facilities and Services Excise Tax Regulations (26 CFR part 49) under sections 4261, 4262, 4263, 4264, 4271,

4281, and 4282 of the Internal Revenue Code (Code). This document also contains proposed amendments to the Excise Tax Procedural Regulations (26 CFR part 40).

Section 4261 imposes an excise tax on certain amounts paid for transportation of persons by air. Section 4271 imposes an excise tax on certain amounts paid for transportation of property by air. The excise taxes imposed by sections 4261 and 4271 (collectively, air transportation excise tax), as well as certain Federal fuel taxes, are deposited into the Airport and Airway Trust Fund, which funds the Federal Aviation Administration's (FAA) operations, air transportation infrastructure, and other aviation-related programs. See section 9502 of the Code.

Section 13822 of Public Law 115-97, 131 Stat. 2054, 2182 (2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA), amended the Code by adding paragraph (e)(5) to section 4261. The new provision provides that no tax shall be imposed by section 4261 or 4271 on any amount paid by an aircraft owner for aircraft management services related to: (1) maintenance and support of the aircraft owner's aircraft, or (2) flights on the aircraft owner's aircraft.

Section 4261(e)(5)(B) defines the term "aircraft management services" to include assisting an aircraft owner with: (1) administrative and support services, such as scheduling, flight planning, and weather forecasting; (2) obtaining insurance; (3) maintenance, storage, and fueling of aircraft; (4) hiring, training, and provision of pilots and crew; (5) establishing and complying with safety standards; and (6) such other services as are necessary to support flights operated by an aircraft owner.

Section 4261(e)(5)(C)(i) provides that the term "aircraft owner" includes a person who leases an aircraft other than under a "disqualified lease." Section 4261(e)(5)(C)(ii)

defines the term “disqualified lease” for purposes of section 4261(e)(5)(C)(i) as a lease from a person providing aircraft management services with respect to the aircraft (or a related person (within the meaning of section 465(b)(3)(C)) to the person providing such services), if the lease is for a term of 31 days or less.

Finally, section 4261(e)(5)(D) provides that in the case of amounts paid to any person which (but for section 4261(e)(5)) are subject to air transportation excise tax, a portion of which consists of amounts described in section 4261(e)(5)(A), section 4261(e)(5) shall apply on a pro rata basis only to the portion which consists of amounts described in section 4261(e)(5)(A).

The Conference Report accompanying the TCJA, H.R. Rep. No. 115-466, at 536 (2017) (Conference Report), explains that section 4261(e)(5) “exempts certain payments related to the management of private aircraft from the excise taxes imposed on taxable transportation of persons by air.” The Conference Report further explains that certain arrangements that do not qualify a person as an “aircraft owner” for purposes of section 4261(e)(5) include ownership of stock in a commercial airline and participation in a fractional ownership aircraft program. Id. at 536 n.1190.

With regard to commercial airlines, the Conference Report specifically states that ownership of stock in a commercial airline cannot qualify an individual as an “aircraft owner” of a commercial airline’s aircraft, and amounts paid for transportation on such flights remain subject to air transportation excise tax. Id.

The Conference Report further states that participation in a fractional ownership aircraft program does not constitute “aircraft ownership” for purposes of section 4261(e)(5). Id. Amounts paid to a fractional ownership aircraft program for

transportation under such a program are already exempt from air transportation excise tax pursuant to section 4261(j) if certain requirements provided in section 4043 of the Code are satisfied, including that the aircraft is operated under subpart K of part 91 of Title 14 of the Code of Federal Regulations (subpart K). Id. Flights under a fractional ownership aircraft program are subject to both the fuel tax levied on noncommercial aviation and an additional fuel surtax imposed by section 4043 (fuel surtax). Id. As a result, the Conference Report explains that “a business arrangement seeking to circumvent the fuel surtax by operating outside of subpart K, allowing an aircraft owner the right to use any of a fleet of aircraft, be it through an aircraft interchange agreement, through holding nominal shares in a fleet of aircraft, or any other arrangement that does not reflect true tax ownership of the aircraft being flown upon, is not considered ownership for purposes of [section 4261(e)(5)].” Id.

With regard to the pro rata allocation rule in section 4261(e)(5)(D), the Conference Report states that in the event that a payment made to an aircraft management company is allocated in part to exempt services and flights on the aircraft owner’s aircraft, and in part to flights on aircraft other than that of the aircraft owner, air transportation excise tax must be collected on that portion of the payment attributable to flights on aircraft not owned by the aircraft owner. Id. at 536.

Section 4007 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Pub. L. 116-136, 134 Stat. 181 (2020), created an excise tax holiday on certain aviation taxes by suspending air transportation excise tax and certain fuel excise taxes from March 28, 2020, through December 31, 2020. Nothing in these proposed regulations should be construed as affecting the excise tax holiday created by the

CARES Act. In addition, except with regard to the provisions in 26 CFR part 40, the Treasury decision adopting these proposed regulations as final regulations will apply no sooner than January 1, 2021.

Explanation of Provisions

1. Aircraft Management Services

The proposed regulations provide rules related to the exemption from air transportation excise tax for amounts paid by an aircraft owner for aircraft management services pursuant to section 4261(e)(5).

During the development of these proposed regulations, the Treasury Department and the IRS received various requests for guidance from stakeholders (referred to herein as “commenters”) related to the first five issues discussed in part 1 of this Explanation of Provisions.

a. Applicability of Possession, Command, and Control Test

Commenters requested clarification on the applicability of the possession, command, and control test in existing guidance to amounts paid for aircraft management services in light of section 4261(e)(5). The possession, command, and control test is a facts-and-circumstances analytical framework that is used to determine whether a person is providing taxable transportation to another person in cases where each of the parties contribute some, but not all, of the elements necessary for complete air transportation services. See e.g., Rev. Rul. 60-311 (1960-2 C.B. 341), Rev. Rul. 70-325 (1970-1 C.B. 231), and Rev. Rul. 76-394 (1976-2 C.B. 355). Section 4261(e)(5) directly addresses a situation that, but for section 4261(e)(5), would be analyzed using the possession, command, and control test. As a result, in situations to which the

section 4261(e)(5) exemption applies, the possession, command, and control test is not relevant.

b. *Related-Party Payments*

The second issue for which commenters requested guidance relates to the treatment of payments for aircraft management services made by a person who has a close relationship to the aircraft owner, but is not itself the owner of the aircraft. The commenters suggested that payments that are made by certain parties related to the aircraft owner should be considered as though made by the aircraft owner.

First, the commenters suggested that the proposed regulations should treat payments made by one member of an affiliated group (as that term is used in section 4282) on behalf of an aircraft owner that is a member of the same affiliated group as being made by the aircraft owner.

Second, the commenters suggested that payments made by an owner of a special purpose entity should be treated as being made by the aircraft owner if the special purpose entity owns the aircraft. For example, individuals and corporations often create a single member limited liability company (SMLLC) to own an aircraft in order to comply with FAA regulations or limit liability exposure. In such cases, the owner of the SMLLC often makes payments for aircraft management services on behalf of the SMLLC.

Finally, the commenters suggested that payments made by an aircraft owner's family members, as well as other persons and entities (for example, trusts, as well as the trust's fiduciaries and beneficiaries) closely related to an aircraft owner be treated as being made by the aircraft owner. For this purpose, the commenters suggested that the

proposed regulations should treat payments for aircraft management services made on behalf of the aircraft owner by a family member of the aircraft owner and by persons and entities bearing relationships to the aircraft owner described in sections 267(b) and 707(b) of the Code as amounts paid by the aircraft owner.

The Treasury Department and the IRS understand that it is common practice in the private aviation sector for persons that bear certain close relationships to an aircraft owner to make payments for aircraft management services on behalf of the aircraft owner. However, exceptions to tax, like deductions, are matters of legislative grace, and such provisions are construed narrowly. See Comm’r v. Nat’l Alfalfa Dehydrating & Milling Co., 417 U.S. 134, 148-9 (1974) (“The propriety of a deduction [...] depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.” (citations omitted)); Shami v. Comm’r, 741 F.3d 560, 567 (5th Cir. 2014) (“Tax credits are a matter of legislative grace, are only allowed as clearly provided for by statute, and are narrowly construed.” (citation omitted)); Lettie Pate Whitehead Found., Inc. v. U.S., 606 F.2d 534, 539 (5th Cir. 1979) (“Deductions are matters of legislative grace and must be narrowly construed.” (citation omitted)); Chrysler Corp. v. Comm’r, 436 F.3d 644, 654 (6th Cir. 2006) (“While statutes imposing a tax are generally construed liberally in favor of the taxpayer, those granting a deduction are matters of legislative grace and are strictly construed in favor of the government.” (citations omitted)). Section 4261(e)(5) specifically states that the exemption applies to “amounts paid by an aircraft owner” and makes no reference to any other entity or arrangement. The Treasury Department and the IRS are concerned that if the regulations were to treat payments for aircraft management services made on behalf of

an aircraft owner (other than in a principal-agent scenario in which the aircraft owner is the principal) as being made by the aircraft owner itself, the regulations would effectively expand the exemption in a manner not authorized by Congress.

Additionally, a qualified subchapter S subsidiary (QSub) (as defined in section 1361(b)(3)(B)) that is generally not treated as a separate corporation from its S corporation owner under section 1361(b)(3)(A), and a non-corporate, wholly-owned business entity, such as a SMLLC, that is disregarded as an entity separate from its owner for Federal income tax purposes (under §§301.7701-1 through 301.7701-3 of the Procedure and Administration Regulations), are each treated as an entity separate from its owner for certain Federal excise tax purposes. See §1.1361-4(a)(8) of the Income Tax Regulations and §301.7701-2(c)(2)(v). The rules under §§1.1361-4(a)(8) and 301.7701-2(c)(2)(v) were adopted because difficulties arose from the interaction of the rules in section 1361(b)(3)(A) and §§301.7701-1 through 301.7701-3 with the Federal excise tax rules. It would be contrary to the existing rules in §§1.1361-4(a)(8) and 301.7701-2(c)(2)(v) to treat a person or entity that is separate from the aircraft owner as the aircraft owner for purposes of the exemption from air transportation excise tax in section 4261(e)(5). For these reasons, the proposed regulations do not adopt the commenters' suggestion to provide a related-party rule.

c. Choice of Flight Rules

The third issue for which commenters requested guidance relates to whether an aircraft owner's decision to operate its aircraft under certain parts of the Federal Aviation Regulations (FARs) promulgated by the FAA affects the application of section 4261(e)(5). Part 91 of the FARs governs general aviation. However, some aircraft

owners choose to operate their aircraft under Part 135 of the FARs (governing on-demand and commuter flights), which imposes additional FAA regulatory requirements related to operational safety and enhanced liability protection. Commenters suggested that the proposed regulations provide that if an aircraft owner elects to conduct flights on its own aircraft under Part 135 of the FARs (rather than under Part 91 of the FARs), then payments made by the aircraft owner for aircraft management services related to those flights qualify for the exemption provided in section 4261(e)(5) in the same manner as a flight conducted under Part 91 of the FARs.

It has long been the position of the Treasury Department and the IRS that rules promulgated by the FAA, including the FARs, do not control for Federal excise tax purposes. See Rev. Rul. 78-75 (1978-1 C.B. 340). Further, section 4261(e)(5) makes no reference to the FARs; under the plain language of section 4261(e)(5), its application does not depend upon the FAR flight rules under which an aircraft is operated. The Treasury Department and the IRS agree with the commenters' suggestion. Accordingly, the proposed regulations provide that whether an aircraft owner operates its aircraft pursuant to the rules under FARs Part 91 or pursuant to the rules under FARs Part 135 does not affect the application of section 4261(e)(5).

d. *Charters*

The fourth issue for which commenters requested guidance relates to situations in which an aircraft owner permits an air charter operator (which may or may not be the same person as the person or persons providing aircraft management services to the aircraft owner) to use the aircraft owner's aircraft to provide charter flights. It is common for an aircraft owner to permit an air charter operator to use the aircraft owner's aircraft

for a fee (in cash or in kind) when the aircraft would otherwise sit idle or when the aircraft is being repositioned and would otherwise not carry any passengers. In such instances, amounts paid for charter flights operated on the aircraft owner's aircraft are subject to air transportation excise tax, unless otherwise exempt from the taxes (for example, in the case of an aircraft used as an air ambulance dedicated to acute care emergency medical services under section 4261(g)(2)). See §49.4261-7(h) for the rules regarding the taxation of charter flights.

The commenters suggested that the proposed regulations clarify that the application of section 4261(e)(5) is not affected by an aircraft owner permitting a charter operator to use the aircraft owner's aircraft for charter flights. The Treasury Department and the IRS agree with the commenters that, in general, the application of section 4261(e)(5) should not be affected by an aircraft owner permitting an aircraft management services provider or other person to use the aircraft owner's aircraft for for-hire flights (such as charter flights, air taxi flights, and flightseeing flights). Accordingly, the proposed regulations provide that whether an aircraft owner permits its aircraft to be used for for-hire flights does not affect the application of section 4261(e)(5) to amounts paid by the aircraft owner for aircraft management services.

The proposed regulations also clarify that to the extent such for-hire flights are subject to the tax imposed by section 4261 or 4271, taxable fuel (as defined in section 4083(a) of the Code) or any other liquid taxable under section 4041(c) of the Code that is used as fuel on such flights is used in commercial aviation, as that term is defined in section 4083(b). See sections 4081(a)(2) and 4041(c) for the applicable fuel tax rates.

e. *Payment Arrangements*

The fifth issue for which commenters requested guidance relates to business decisions made by a person providing aircraft management services regarding how to charge, invoice, or bill (referred to collectively herein as “bill” or “billed”) aircraft owners for their services. An aircraft owner may be billed for aircraft management services in a variety of ways. For example, an aircraft owner may be charged a monthly fee for aircraft management services and an hourly fee for each hour of flight time.

Alternatively, an aircraft owner may be billed for specific costs related to the operation of the aircraft, plus a mark-up to compensate the aircraft management services provider.

In addition to these two examples, there are many other possible arrangements that may be used to bill an aircraft owner based on the particular agreement between an aircraft owner and the aircraft management services provider. The commenters suggested that the proposed regulations should clarify that the manner in which an aircraft owner is billed for aircraft management services should not control whether the exemption from air transportation excise tax provided in section 4261(e)(5) applies to amounts paid for those services.

The Treasury Department and the IRS agree with the commenters that the manner in which an aircraft owner is billed for aircraft management services is a business decision that providers of aircraft management services and aircraft owners should be free to make with each other in order to satisfy their particular needs. Accordingly, the proposed regulations provide that the method or manner by which an aircraft owner is billed for aircraft management services does not affect whether the

exemption from air transportation excise tax provided in section 4261(e)(5) applies to amounts paid for those services.

While the proposed regulations acknowledge that the manner in which an aircraft owner is billed for aircraft management services is a business decision, the proposed regulations require both the aircraft owner and the aircraft management services provider to maintain adequate records to show that amounts paid by the aircraft owner to the aircraft management services provider relate to aircraft management services specifically for the aircraft owner's aircraft or for flights on the aircraft owner's aircraft.

f. *Other Proposed Aircraft Management Services Rules*

The proposed regulations clarify that the exemption from air transportation excise tax in section 4261(e)(5) is limited to private aviation. Section 49.4261-10(b)(6) of the proposed regulations defines "private aviation" as the use of an aircraft for civilian flights except scheduled passenger service. This rule is consistent with the Conference Report, which explicitly states that section 4261(e)(5) "exempts certain payments related to the management of private aircraft from the excise taxes imposed on taxable transportation by air." Conference Report at 536.

The proposed regulations also clarify the application of section 4261(e)(5)(D), which requires a pro rata allocation of the amounts paid for aircraft management services between services that relate to flights taken by an aircraft owner on the aircraft owner's aircraft and services that relate to flights taken by an aircraft owner on an aircraft that is not owned by the aircraft owner. An aircraft that is not owned by the aircraft owner is referred to in the proposed regulations as a "substitute aircraft." Section 4261(e)(5)(D) limits the section 4261(e)(5) exemption to amounts paid for

aircraft management services related to flights taken by an aircraft owner on the aircraft owner's aircraft. Therefore, the section 4261(e)(5) exemption does not extend to those amounts paid for aircraft management services that relate to flights taken by an aircraft owner on a substitute aircraft (that is, an aircraft not owned by the aircraft owner). The proposed regulations provide that the pro rata allocation is calculated by applying to the amount paid by the aircraft owner for aircraft management services the ratio of flight hours provided on substitute aircraft during the calendar quarter over the total flight hours flown by the aircraft owner on both the aircraft owner's aircraft and substitute aircraft during the calendar quarter. The Treasury Department and the IRS request comments regarding whether the proposed flight hour ratio allocation method is fair and practicable or whether a different allocation method should be required (and if so, what exactly such required method should be).

In addition, the proposed regulations clarify that taxable fuel (as defined in section 4083(a)) or any other liquid taxable under section 4041(c) that is used as fuel on a flight for which amounts paid are exempt from the taxes imposed by sections 4261 and 4271 by reason of section 4261(e)(5) is not fuel used in commercial aviation, as that term is defined in section 4083(b). See sections 4081(a)(2) and 4041(c) for the applicable fuel tax rates.

Finally, the section 4043 fuel surtax applies to fuel used in fractional program aircraft operated under FARs Part 91K (14 CFR part 91K) but not to fuel used on flights for which amounts paid are exempt by reason of section 4261(e)(5). The Treasury Department and the IRS are concerned that this creates an incentive for persons to operate flights that would otherwise be subject to the section 4043 fuel surtax outside of

FARs Part 91K in order to avoid the surtax. In these instances, such persons would likely also argue that amounts paid for aircraft management services related to the fractional program aircraft are exempt from air transportation excise tax under section 4261(e)(5).

To address this issue, the proposed regulations include an anti-abuse rule providing that the section 4261(e)(5) exemption does not apply to any amount paid for aircraft management services by a participant in any transaction or arrangement, or through other means, that seeks to circumvent the surtax imposed by section 4043. In addition, the proposed regulations clarify that the section 4261(e)(5) exemption does not apply to amounts paid for aircraft management services related to flights on fractional program aircraft operated (or required to be operated) under FARs Part 91K. The proposed regulations also provide that if an amount paid qualifies for both the exemption provided in section 4261(e)(5) and the exemption provided in section 4261(j), the section 4261(j) exemption applies to the amount paid and the surtax imposed by section 4043 applies to any liquid used in the fractional program aircraft as fuel. See sections 4261(j) and 4043. This provision is consistent with the Conference Report and the definition of “aircraft owner” in §49.4261-10(b)(3)(B) in the proposed regulations.

2. Additional Proposed Changes to the Regulations

a. *Changes to Part 40*

The privilege to file consolidated returns under section 1501 applies only to income tax returns and not to excise tax returns. The proposed regulations add §40.0-1(d) to note this rule and also reflect the rules of §§1.1361-4(a)(8) and 301.7701-2(c)(2)(v) that treat QSubs and certain business entities as entities separate from their

owners for Federal excise tax purposes. See also Revenue Ruling 2008-18 (2008-1 C.B. 674). Thus, proposed §40.0-1(d) treats each business unit that has, or is required to have, a separate Employer Identification Number as a separate person. In the context of air transportation excise tax, this rule applies with respect to both the person required to pay the tax under proposed §49.4261-1(b) and the person required to collect and pay over the tax under §40.6011(a)-1(a)(3) and section 4291 of the Code.

Proposed §40.0-1(d) was originally proposed on July 29, 2008, in a notice of proposed rulemaking (REG-155087-05) published in the **Federal Register** (73 FR 43890), but the rules in that regulation project have not been finalized. Because of the length of time that has passed since it was originally proposed, this document withdraws proposed §40.0-1(d) and re-proposes the provision as part of these proposed regulations.

Existing §40.6071(a)-3 provides excise tax return filing rules that apply only to the quarterly return required under §40.6011(a)-1(a) for the third calendar quarter of 2001. The proposed regulations remove §40.6071(a)-3 in its entirety because it is obsolete.

b. *Changes to Part 49*

The existing regulations under section 4261 have not been revised since 1962. The proposed regulations remove existing language relating to taxes on transportation by rail, motor vehicle, and water, which have been repealed, and otherwise update the existing regulations to conform to current law. The proposed regulations also remove references to exemptions that were repealed in 1970. More specifically, the proposed regulations update §49.4261-1 to reflect: (i) the enactment of the international travel

facilities tax in 1970 (Airport and Airway Development Act of 1970 (AADA), Pub. L. No. 91-258, 84 Stat. 236 (1970)); (ii) the enactment of the domestic segment tax in 1997 (Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (1997)), and (iii) the current statutory exemptions from tax under sections 4261(e)(5), 4261(f), 4261(g), 4261(h), 4261(j), 4281, 4282, and 4293 of the Code.

Section 49.4261-1(b)(1) of the proposed regulations incorporates the payment and collection rules in sections 4261(d) and 4291.

Section 49.4261-1(b)(2) of the proposed regulations reflects the statutory change to section 4263(c) under section 1031 of the Taxpayer Relief Act of 1997, and case law interpreting that revision. Under prior law, section 4263(c) provided that where any tax imposed by section 4261 was not paid at the time payment for transportation was made, the tax was paid by the person paying for the transportation or by the person using the transportation. In other words, the prior law placed no payment obligation on the air carrier. The current version of section 4263(c) provides that where any tax imposed by section 4261 is not paid at the time the payment for transportation is made, the air carrier providing the initial segment of transportation that begins and ends in the United States is liable for the tax. Several courts have rejected arguments that current section 4263(c) imposes only secondary liability for the applicable section 4261 tax on the air carrier if the tax is not otherwise collected. See Sundance Helicopters, Inc. v. U.S., 104 Fed. Cl. 1, 11 (2012) ("The plain language of IRC [section] 4263(c) provides that the air carrier is to pay the tax if it is not otherwise collected. There is no mention of primary versus secondary liability in the text of the statute [...] The language of IRC [section] 4263(c) clearly imposes a payment obligation on the air carrier."); Temsco Helicopters,

Inc. v. U.S., 409 F.App'x. 64, 67 (9th Cir. 2010) ("nothing in [section] 4263(c) requires that the government first attempt to collect the [air transportation excise tax] from the purchasers..."); Papillon Airways, Inc. v. U.S., 105 Fed. Cl. 154, 163 (2012) (IRC 4263(c) makes "the carrier's liability conditional on *whether the tax was collected* at the time payment for transportation was made, *not whether the government is unsuccessful at collecting the tax.*" (emphasis in original)).

Section 49.4261-1(d) of the proposed regulations generally incorporates the holdings of Revenue Ruling 71-126 (1971-1 C.B. 363) regarding the general applicability of the section 4261 taxes to the transportation of persons on all types of aircraft, and Revenue Ruling 67-414 (1967-2 C.B. 382) regarding the inapplicability of the section 4261 taxes to the transportation of persons on hovercraft.

Section 49.4261-2 of the proposed regulations generally updates the existing regulations to reflect the statutory additions of the domestic segment tax and the international travel facilities tax to section 4261. This section also incorporates the holdings in Revenue Ruling 72-309 (1972-1 C.B. 348) and Revenue Ruling 2002-34 (2002-1 C.B. 1150) regarding the computation of the domestic segment tax and the international travel facilities tax.

Section 49.4261-9(a) of the proposed regulations reflects the rule in section 4261(e)(3)(A) regarding the tax treatment of mileage awards. The Treasury Department and the IRS are currently considering whether to exercise their authority under section 4261(e)(3)(C) to prescribe rules for excluding from the tax base amounts attributable to mileage awards that are used other than for transportation of persons by air. See Notice 2015-76 (2015-46 I.R.B. 669). Nothing in these proposed regulations can be

construed as an exercise of that authority. The proposed regulations reserve §49.4261-9(b) for the possible future exercise of the authority granted to the Secretary of the Treasury or his delegate under section 4261(e)(3)(C).

The regulations under sections 4262 and 4263 also have generally not been revised since the 1960s. Amendments to the Code since then, including the repeal of the seats and berths tax, a change to the definition of “uninterrupted international air transportation” under section 4262(c)(3), and a change to the rules in section 4263(c), have rendered certain provisions in the existing regulations obsolete. The proposed regulations remove obsolete provisions and generally update the existing regulations to conform to current law.

Section 4264 of the Code was redesignated as section 4263 in 1970 by Title II, section 205(c)(2), of the AADA. However, the regulations under section 4264 were not similarly redesignated. The proposed regulations redesignate the current section 4264 regulations as section 4263 regulations, remove obsolete provisions, and generally update the existing regulations to conform to current law.

The proposed regulations update the rule in §49.4263-5 (which the proposed regulations redesignate as §49.4281-1) relating to small aircraft on nonestablished lines to reflect statutory changes to the exemption. Specifically, the current regulation provides, in relevant part, that amounts paid to transport a person on a small aircraft are “exempt from the tax imposed under section 4261 provided the aircraft: (1) has a gross take-off weight of less than 12,500 pounds [...] and (2) has a passenger seating capacity of less than 10 adult passengers, including the pilot.” In 1970, the permissible aircraft weight to qualify for the exemption for small aircraft on nonestablished lines was

reduced to a maximum certificated take-off weight of 6,000 pounds or less and the maximum passenger seating capacity rule was eliminated. AADA, Title II, section 205(a)(1). In 2005, Congress amended section 4281 to clarify that flights for which the sole purpose is sightseeing are not considered to be operated on an established line. Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, Pub. L. No. 109-59, section 11124(a), 119 Stat 1144 (2005). In 2012, Congress amended section 4281 to exclude jet aircraft from the exemption. FAA Modernization and Reform Act of 2012, Pub. L. No. 112-95, section 1107(a), 126 Stat 11 (2012). The proposed regulations incorporate the changes to the exemption for small aircraft on nonestablished lines as described above.

Section 4282 provides an exemption from the taxes imposed by section 4261 and 4271 for certain transportation by air for members of an affiliated group. The Treasury Department and the IRS have not issued regulations regarding this provision. The proposed regulations reserve §49.4282-1 for future rules regarding the affiliated group exemption under section 4282.

The updates to part 49 in these proposed regulations are not comprehensive and do not fully update every provision and example that require modernization. The updates are intended to address only the most straightforward and well-settled issues; they are not intended to introduce new rules or address issues that may require a more nuanced approach. The Treasury Department and the IRS believe that these updates will help reduce the burden on taxpayers, collectors, and revenue agents by providing much needed basic updates to the part 49 regulations.

Effect on Other Documents

Revenue Ruling 67-414 (1967-2 C.B. 382), Revenue Ruling 72-309 (1972-1 C.B. 348), and Revenue Ruling 2002-34 (2002-1 C.B. 1150) will be obsoleted on the date these regulations are published as final regulations in the **Federal Register**.

Partial Withdrawal of Proposed Regulations

Under the authority of 26 U.S.C. 7805, §40.0-1(d) of the notice of proposed rulemaking (REG-155087-05) published in the **Federal Register** on July 29, 2008 (73 FR 43890) is withdrawn.

Proposed Applicability Date

The regulations, other than §40.0-1(d), generally are proposed to apply on and after the later of the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register** or January 1, 2021. Section 40.0-1(d) of the regulations is proposed to apply on and after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

Special Analyses

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and the Office of Management and Budget regarding review of tax regulations.

Because the regulation does not impose a collection of information on small entities a Regulatory Flexibility Act (5 U.S.C. chapter 6) analysis is not required.

Pursuant to section 7805(f) of the Code these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, Notices and other guidance cited in this document are published in the Internal Revenue Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

Comments and Requests for a Public Hearing

Before these proposed amendments to the regulations are adopted as final regulations, consideration will be given to comments that are submitted timely to the IRS as prescribed in the preamble under the “**ADDRESSES**” section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any electronic comments submitted, and to the extent practicable any paper comments submitted, will be made available at www.regulations.gov or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**. Announcement 2020-4 (2020-17 I.R.B. 1) provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

Drafting Information

The principal authors of these regulations are Michael H. Beker and Rachel S. Smith, Office of the Associate Chief Counsel (Passthroughs and Special Industries).

However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects

26 CFR Part 40

Excise taxes, Reporting and recordkeeping requirements.

26 CFR Part 49

Excise taxes, Reporting and recordkeeping requirements, Telephone, Transportation.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 40 and 49 are proposed to be amended as follows:

PART 40--EXCISE TAX PROCEDURAL REGULATIONS

Paragraph 1. The authority citation for part 40 is amended by removing the entry for §40.6071(a)-3 to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 40.0-1 is amended by redesignating paragraph (d) as paragraph (e), adding a new paragraph (d), and revising newly redesignated paragraph (e) to read as follows:

§40.0-1 Introduction.

* * * * *

(d) Person. For purposes of this part, each business unit that has, or is required to have, a separate employer identification number is treated as a separate person. Thus, business units (for example, a parent corporation and a subsidiary corporation, a partner and the partner's partnership, or the various members of a consolidated group),

each of which has, or is required to have, a different employer identification number, are separate persons.

(e) Applicability date--(1) Paragraphs (a), (b), and (c). Paragraphs (a), (b), and (c) of this section apply to returns that relate to periods beginning after March 31, 2013. For rules that apply before that date, see 26 CFR part 40, revised as of April 1, 2013.

(2) Paragraph (d). Paragraph (d) of this section applies to returns that relate to periods beginning on or after [date these regulations are published as final regulations in the **Federal Register**]. For rules that apply before that date, see 26 CFR part 40, revised as of April 1, 2020.

§40.6071(a)-3 [Removed]

Par. 3. Section 40.6071(a)-3 is removed.

PART 49--FACILITIES AND SERVICES EXCISE TAX REGULATIONS

Par. 4. The authority citation for part 49 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 5. Section 49.4261-1 is revised to read as follows:

§49.4261-1 Imposition of tax; in general.

(a) In general. Section 4261 of the Internal Revenue Code (Code) imposes three separate taxes on amounts paid for certain transportation of persons by air. Tax attaches at the time of payment for any transportation taxable under section 4261. The applicability of each section 4261 tax is generally determined on a flight-by-flight basis.

(1) Percentage tax. Section 4261(a) imposes a 7.5 percent tax on the amount paid for the taxable transportation of any person. See section 4262(a) of the Code and §49.4262-1(a) for the definition of the term taxable transportation.

(2) Domestic segment tax. Section 4261(b)(1) imposes a \$3 tax (indexed annually for inflation pursuant to section 4261(e)(4)) on the amount paid for each domestic segment of taxable transportation. See section 4261(b)(2) for the definition of the term domestic segment. The domestic segment tax does not apply to a domestic segment beginning or ending at an airport that is a rural airport for the calendar year in which the segment begins or ends (as the case may be). See section 4261(e)(1)(B) for the definition of the term rural airport.

(3) International travel facilities tax. Section 4261(c) imposes a \$12 tax (indexed annually for inflation pursuant to section 4261(e)(4)) on any amount paid (whether within or without the United States) for any transportation by air that begins or ends in the United States. The international travel facilities tax does not apply to any transportation that is entirely taxable under section 4261(a) (determined without regard to sections 4281 and 4282). See section 4261(c)(2). A special rule applies to Alaska and Hawaii flights. See section 4261(c)(3).

(b) Payment and collection obligations--(1) In general. The taxes imposed by section 4261 are collected taxes. In general, the person making the payment subject to tax is the taxpayer. See section 4261(d). The person receiving the payment is the collector (also commonly referred to as the collecting agent). See section 4291 of the Code. The collector must collect the applicable tax from the taxpayer, report the tax on Form 720, Quarterly Federal Excise Tax Return, and remit the tax to the Internal Revenue Service. See sections 4291, 6011, and 7501 of the Code. See §40.6011(a)-1 of this chapter and §49.4291-1. The collector must also make semimonthly deposits of the taxes imposed by section 4261. See section 6302(e) of the Code. See §§40.0-1(c),

40.6302(c)-1, and 40.6302(c)-3 of this chapter. See section 4263(a) and (c) of the Code for special rules relating to the payment and collection of tax.

(2) Failure to collect tax. Where any tax imposed by section 4261 is not paid at the time payment for transportation is made, then, to the extent the tax is not collected under any other provision of subchapter C of chapter 33 of the Code, the tax must be paid by the carrier providing the initial segment of transportation that begins or ends in the United States. See section 4263(c). In other words, if an amount paid for transportation is subject to tax under section 4261 and the applicable tax is not collected at the time the payment is made, the carrier providing the initial segment of transportation that begins or ends in the United States is liable for the tax. See section 6672 of the Code for rules relating to the application of the trust fund recovery penalty.

(c) Type of aircraft. The taxes imposed by section 4261 generally apply regardless of the type of aircraft on which the transportation is provided, provided all of the other conditions for liability are present and no specific statutory exemption applies. See paragraph (f) of this section for a list of statutory exemptions from tax. Amounts paid for the transportation of persons by air cushion vehicles, also known as hovercraft, are not subject to the taxes imposed by section 4261.

(d) Purpose of transportation. The purpose of the transportation (for example, business or pleasure) is not a factor in determining taxability under section 4261.

(e) Routes. Amounts paid for transportation may be taxable even if the transportation is not between two definite points. Unless otherwise exempt, a payment for continuous transportation that begins and ends at the same point is subject to tax.

See section 4281 of the Code and §49.4282-1 for the exemption for small aircraft on nonestablished lines.

(f) Exemptions from tax; cross-references--(1) Aircraft management services.

For the exemption for certain aircraft management services, see section 4261(e)(5) of the Code and §49.4261-10.

(2) Hard minerals, oil, and gas. For the exemption for certain uses related to the exploration, development, or removal of hard minerals, oil, or gas, see section 4261(f)(1).

(3) Trees and logging operations. For the exemption for certain uses related to trees and logging operations, see section 4261(f)(2).

(4) Air ambulances. For the exemption for air ambulances providing certain emergency medical transportation, see section 4261(g).

(5) Skydiving. For the exemption for certain skydiving uses, see section 4261(h).

(6) Seaplanes. For the exemption for certain seaplane segments, see section 4261(i).

(7) Fractionally-owned aircraft. For the exemption for certain aircraft in fractional ownership aircraft programs, see section 4261(j).

(8) Small aircraft on nonestablished lines. For the exemption for certain small aircraft on nonestablished lines, see section 4281 of the Code and §49.4281-1.

(9) Affiliated groups. For the exemption for certain transportation of members of an affiliated group, see section 4282.

(10) United States and territories. For exemptions authorized by the Secretary of the Treasury or his delegate for the exclusive use of the United States, see section 4293.

(g) Applicability date. This section applies on and after the later of [date these regulations are published as final regulations in the **Federal Register**] or January 1, 2021. For rules that apply before that date, see 26 CFR part 49, revised as of April 1, 2020.

Par. 6. Section 49.4261-2 is amended by:

1. Revising paragraphs (a) and (b).
2. Adding paragraph (d).

The revisions and addition read as follows:

§49.4261-2 Application of tax.

(a) Tax on total amount paid. The tax imposed by section 4261(a) of the Internal Revenue Code (Code) is measured by the total amount paid for taxable transportation, whether paid in cash or in kind.

(b) Tax on transportation of each person. The taxes imposed by section 4261(b) and (c) of the Code are head taxes and, therefore, apply on a per-passenger basis. The taxes apply to each passenger for whom an amount is paid, regardless of whether the payment is made as a single lump sum or is made individually for each passenger. In the case of charter flights for which a fixed amount is paid, the section 4261(b) and (c) taxes are computed by multiplying the applicable rate of tax by the number of passengers transported on the aircraft.

* * * * *

(d) Applicability date. Paragraphs (a) and (b) of this section apply on and after the later of [date these regulations are published as final regulations in the **Federal Register**] or January 1, 2021. For rules that apply before that date, see 26 CFR part 49, revised as of April 1, 2020.

Par. 7. Section 49.4261-3 is amended by:

1. Removing “§49.4262(c)-1” wherever it appears and adding “§49.4262-3” in its place.

2. In the first sentence of paragraph (a), removing “The tax imposed by section 4261(a)” and adding “The taxes imposed by section 4261(a) and (b) of the Internal Revenue Code (Code)” in its place.

3. In the second sentence of paragraph (a), adding “under section 4261(a) and (b)” at the end of the sentence.

4. Removing (b) introductory text and (b)(1) and redesignating paragraph (b)(2) as paragraph (b).

5. Revising newly redesignated paragraph (b).

6. Revising paragraph (c).

7. In paragraph (d), removing “section 4262(b) and §49.4262(b)-1” and adding “section 4262(b) of the Code and §49.4262-2” in its place.

8. Adding paragraph (e).

The revisions and additions read as follows:

§49.4261-3 Payments made within the United States.

* * * * *

(b) Other transportation. In the case of transportation, other than that described in paragraph (a) of this section, for which payment is made in the United States, the taxes imposed by section 4261(a) and (b) apply with respect to the amount paid for that portion of such transportation by air which is directly or indirectly from one port or station in the United States to another port or station in the United States, but only if such portion is not a part of uninterrupted international air transportation within the meaning of section 4262(c)(3) of the Code and §49.4262-3(c). Transportation that:

(1) Begins in the United States or the 225-mile zone and ends outside such area,

(2) Begins outside the United States or the 225-mile zone and ends inside such area, or

(3) Begins outside the United States and ends outside such area, is taxable only with respect to such portion of the transportation by air which is directly or indirectly from one port or station in the United States to another port or station in the United States, but only if such portion is not a part of “uninterrupted international air transportation” within the meaning of section 4262(c)(3) and §49.4262-3(c). Thus, on a trip by air from Chicago to London, England, with a stopover at New York, for which payment is made in the United States, if the portion from Chicago to New York is not a part of “uninterrupted international air transportation” within the meaning of section 4262(c)(3) and §49.4262-3(c), the taxes would apply to the part of the payment which is applicable to the transportation from Chicago to New York. However, if the portion from

Chicago to New York is a part of “uninterrupted international air transportation” within the meaning of section 4262(c)(3) and §49.4262-3(c), the taxes would not apply.

(c) Method of computing tax on taxable portion. Where a payment is made for transportation which is partially taxable under paragraph (b) of this section, the tax imposed by section 4261(a) may be computed on that proportion of the total amount paid which the mileage of the taxable portion of the transportation bears to the mileage of the entire trip.

* * * * *

(e) Applicability date. This section applies on and after the later of [the date these regulations are published as final regulations in the **Federal Register**] or January 1, 2021. For rules that apply before that date, see 26 CFR part 49, revised as of April 1, 2020.

§49.4261-4 [Amended]

Par. 8. Section 49.4261-4 is amended by:

1. In paragraph (a), removing the first “4261(a)” and add “4261 of the Internal Revenue Code (Code)” in its place.

2. In paragraph (a), removing “section 4261(a) (see section 4264(d))” and adding “section 4261 (see section 4263(d) of the Code)” in its place.

3. In paragraph (b), removing “§49.4262(c)-1” and adding “§49.4262-3” in its place.

4. In the first sentence of paragraph (d), removing “§49.4262(c)-1” and adding “§49.4262-3” in its place.

5. In the first sentence of paragraph (d), removing “six-hour” and adding “12-hour” in its place.

§49.4261-5 [Amended]

Par. 9. Section 49.4261-5 is amended as follows:

1. In paragraph (a), remove “4261(b)” wherever it appears and add “4261(a) and (b)” in its place.

2. In paragraph (c), remove “§49.4262(b)-1” and add “§49.4262-2” in its place.

Par. 10. Section 49.4261-7 is amended by:

1. In the introductory paragraph, removing “4263, 4292, 4293, or 4294” and adding “4261, 4281, 4282 or 4293 of the Internal Revenue Code” in its place.

2. Removing and reserving paragraphs (b), (d), (e), and (g).

3. Revising paragraph (h).

4. In paragraph (i), remove “paragraph (c) of §49.4261-2 and paragraph (f)(4) of §49.4261-8” and add “§§49.4261-2(c) and 49.4261-8(f)(4)” in its place.

5. Adding paragraph (k).

The revision and addition read as follows:

§49.4261-7 Examples of payments subject to tax.

* * * * *

(h) Aircraft charters--(1) When no charge is made by the charterer of an aircraft to the persons transported, the amount paid by the charterer for the charter of the aircraft is subject to tax.

(2) The charterer of an aircraft who sells transportation to other persons must collect and account for the tax with respect to all amounts paid to the charterer by such

other persons. In such case, no tax will be due on the amount paid by the charterer for the charter of the aircraft but it shall be the duty of the owner of the aircraft to advise the charterer of the charterer's obligation for collecting, accounting for, and paying over the tax to the Internal Revenue Service.

* * * * *

(k) Applicability date. Paragraph (h) of this section applies on and after the later of [the date these regulations are published as final regulations in the **Federal Register**] or January 1, 2021. For rules that apply before that date, see 26 CFR part 49, revised as of April 1, 2020.

§49.4261-8 [Amended]

Par. 11. Section 49.4261-8 is amended as follows:

1. In the introductory paragraph, remove "4263, 4292, 4293, or 4294" and add "4261, 4281, 4282 or 4293 of the Internal Revenue Code" in its place.
2. Paragraphs (f)(2), (3), and (5) are removed and reserved.

Par. 12. Section 49.4261-9 is revised to read as follows:

§49.4261-9 Mileage awards.

(a) Tax imposed. Any amount paid (and the value of any other benefit provided) to an air carrier (or any related person) for the right to provide mileage awards for or other reductions in the cost of any transportation of persons by air is an amount paid for taxable transportation and is therefore subject to the tax imposed by section 4261(a) of the Internal Revenue Code. See section 4261(e)(3)(A).

(b) [Reserved]

(c) Applicability date. This section applies on and after the later of [date these regulations are published as final regulations in the **Federal Register**] or January 1, 2021.

Par. 13. Section 49.4261-10 is revised to read as follows:

§49.4261-10 Aircraft management services.

(a) In general--(1) Overview. This section prescribes rules relating to the exemption from tax for amounts paid (in cash or in kind) by an aircraft owner to an aircraft management services provider for certain aircraft management services. Pursuant to section 4261(e)(5) of the Internal Revenue Code (Code), the taxes imposed by sections 4261 and 4271 of the Code do not apply to amounts paid by an aircraft owner to an aircraft management services provider for aircraft management services related to maintenance and support of the aircraft owner's aircraft; or related to flights (flight services) on the aircraft owner's aircraft. The exemption in section 4261(e)(5) applies to amounts paid by an aircraft owner to an aircraft management services provider for flight services on the aircraft owner's aircraft, even if the aircraft owner is not on the flight. The exemption in section 4261(e)(5) does not apply to amounts paid to an aircraft management services provider on behalf of an aircraft owner (other than in a principal-agent scenario in which the aircraft owner is the principal). For example, amounts paid for aircraft management services by one member of an affiliated group (as that term is defined in section 4282 of the Code) for flights on an aircraft owned by another member of the affiliated group are not treated as amounts paid by the aircraft owner. See paragraph (b) of this section for definitions of terms used in this section.

(2) Private aviation. The exemption in section 4261(e)(5) is limited to aircraft management services related to aircraft used in private aviation.

(3) Adequate records required. In order to qualify for the exemption in section 4261(e)(5), an aircraft owner and aircraft management services provider must maintain adequate records to show that the amounts paid by the aircraft owner to the aircraft management services provider relate to aircraft management services specifically for the aircraft owner's aircraft or for flights on the aircraft owner's aircraft.

(b) Definitions. This paragraph provides definitions applicable to this section.

(1) Aircraft management services. The term aircraft management services means--

(i) Statutory services. The services listed in section 4261(e)(5)(B); and

(ii) Other services. Any service (including, but not limited to, purchasing fuel, purchasing aircraft parts, and arranging for the fueling of an aircraft owner's aircraft) provided directly or indirectly by an aircraft management services provider to an aircraft owner, that is necessary to keep the aircraft owner's aircraft in an airworthy state or to provide air transportation to the aircraft owner on the aircraft owner's aircraft at a level and quality of service required under the agreement between the aircraft owner and the aircraft management services provider.

(2) Aircraft management services provider. The term aircraft management services provider means a person that provides aircraft management services, as defined in paragraph (b)(1) of this section, to an aircraft owner, as defined in paragraph (b)(3) of this section.

(3) Aircraft owner--(i) In general. The term aircraft owner means an individual or entity that leases or owns (that is, holds title to or substantial incidents of ownership in) an aircraft managed by an aircraft management services provider (commonly referred to as a managed aircraft). The term aircraft owner does not include a lessee of an aircraft under a disqualified lease, as defined in paragraph (b)(4) of this section. A person that owns stock in a commercial airline does not qualify as an aircraft owner of that commercial airline's aircraft.

(ii) Fractional aircraft ownership and similar arrangements. A participant in a fractional aircraft ownership program, as defined in section 4043(c)(2) of the Code, does not qualify as an aircraft owner of the program's managed aircraft if the amount paid for such person's participation is exempt from the taxes imposed by sections 4261 and 4271 by reason of section 4261(j). Similarly, a participant in a business arrangement seeking to circumvent the surtax imposed by section 4043 by operating outside of subpart K of 14 CFR part 91, that allows an aircraft owner the right to use any of a fleet of aircraft (through an aircraft interchange agreement, through holding nominal shares in a fleet of aircraft, or any other similar arrangement), is not an aircraft owner with respect to any of the aircraft owned or leased as part of that business arrangement.

(4) Disqualified lease. The term disqualified lease has the meaning given to it by section 4261(e)(5)(C)(ii). A disqualified lease also includes any arrangement that seeks to circumvent the rule in section 4261(e)(5)(C)(ii) by providing a lease term that is greater than 31 days but does not provide the lessee with exclusive and uninterrupted access and use of the leased aircraft, as identified by the aircraft's airframe serial number and tail number. For purposes of the preceding sentence, the fact that a lease

permits the lessee to use the aircraft for for-hire flights, as defined in paragraph (b)(5) of this section, when the lessee is otherwise not using the aircraft does not, because of this fact alone, cause a lease with a term that is greater than 31 days to be a disqualified lease.

(5) For-hire flight. The term for-hire flight means the use of an aircraft to transport passengers for compensation that is paid in cash or in kind. The term includes, but is not limited to, charter flights, air taxi flights, and sightseeing flights (commonly referred to as flightseeing flights).

(6) Private aviation. The term private aviation means the use of an aircraft for civilian flights except scheduled passenger service.

(7) Substitute aircraft. The term substitute aircraft means an aircraft, other than the aircraft owner's aircraft, that is provided by an aircraft management services provider to the aircraft owner when the aircraft owner's aircraft is not available, regardless of the reason for the unavailability.

(c) Substitute Aircraft--(1) Allocation required. If an aircraft management services provider provides flight services to an aircraft owner on a substitute aircraft during a calendar quarter, the taxes imposed by section 4261 (including the taxes imposed by section 4261(b) or (c), as appropriate, on each passenger transported) or 4271, as the case may be, apply to that portion of the amounts paid by the aircraft owner to the aircraft management services provider, determined on a pro rata basis, as described in paragraph (c)(2) of this section, that are related to the flight services provided on the substitute aircraft.

(2) How calculated. The allocation described in paragraph (c)(1) of this section is calculated by applying to the total amount paid by an aircraft owner to an aircraft management services provider during the calendar quarter the ratio of--

(i) Substitute aircraft hours. The total flight hours provided on substitute aircraft during the calendar quarter; over

(ii) Total hours. The sum of--

(A) The total flight hours made on the aircraft owner's aircraft during the calendar quarter; and

(B) The total flight hours provided to the aircraft owner on substitute aircraft during the calendar quarter.

(d) Choice of flight rules. Whether a flight on an aircraft owner's aircraft operates pursuant to the rules under Federal Aviation Regulations prescribed by the Federal Aviation Administration (FARs) Part 91 (14 CFR part 91) or pursuant to the rules under FARs Part 135 (14 CFR part 135) does not affect the application of section 4261(e)(5).

(e) Aircraft available for hire--(1) In general. Whether an aircraft owner permits an aircraft management services provider or other person to use its aircraft to provide for-hire flights (for example, when the aircraft is not being used by the aircraft owner or when the aircraft is being moved in deadhead service) does not affect the application of section 4261(e)(5). However, an amount paid for for-hire flights on the aircraft owner's aircraft does not qualify for the section 4261(e)(5) exemption. Therefore, an amount paid for a for-hire flight on an aircraft owner's aircraft is subject to the tax imposed by section 4261 or 4271, as the case may be, unless the amount paid is otherwise exempt from the tax imposed by section 4261 or 4271 other than by reason of section

4261(e)(5). See §49.4261-7(h) for rules relating to the application of the tax imposed by section 4261 on amounts paid for charter flights.

(2) Fuel used on for-hire flights. To the extent amounts paid for for-hire flights are subject to the tax imposed by section 4261 or 4271, taxable fuel (as defined in section 4083(a) of the Code) or any liquid taxable under section 4041(c) of the Code that is used as fuel on such flights is used in commercial aviation, as that term is defined in section 4083(b). See sections 4081(a)(2) and 4041(c) for the applicable fuel tax rates.

(f) Billing methods. Except as provided in paragraph (a)(3) of this section (relating to adequate records), the method an aircraft management services provider bills, invoices, or otherwise charges an aircraft owner for aircraft management services, whether by specific itemization of costs, flat monthly or hourly fee, or otherwise, does not affect the application section 4261(e)(5).

(g) Coordination with fuel tax provisions. Taxable fuel (as defined in section 4083(a)) or any liquid taxable under section 4041(c) that is used as fuel on a flight for which amounts paid are exempt from the taxes imposed by sections 4261 and 4271 by reason of section 4261(e)(5) is not fuel used in commercial aviation, as that term is defined in section 4083(b). See sections 4081(a)(2) and 4041(c) for the applicable fuel tax rates.

(h) Multiple aircraft management services providers not disqualifying. Whether an aircraft owner pays amounts to more than one aircraft management services provider for aircraft management services does not affect the application of section 4261(e)(5).

(i) Coordination with exemption for aircraft in fractional ownership aircraft programs and fuel surtax; no choice of exemption; anti-abuse rule. The exemption in section 4261(e)(5) does not apply to any amount paid for aircraft management services by a participant in any transaction or arrangement, or through other means, that seeks to circumvent the surtax imposed by section 4043. Further, the exemption in section 4261(e)(5) does not apply to any amounts paid for aircraft management services related to flights that are (or are required to be) operated under FARs Part 91K (14 CFR part 91K). As a result, if an amount paid qualifies for both the exemption provided in section 4261(e)(5) and the exemption provided in section 4261(j), the exemption provided in section 4261(j) applies to the amount paid and the surtax imposed by section 4043 applies to any liquid used in the managed aircraft as fuel. See sections 4261(j) and 4043.

(j) Examples. The following examples illustrate the provisions of this section.

(1) Example 1--(i) Facts. An aircraft owner, which is organized as corporation under state law, pays a monthly fee of \$1,000 to an aircraft management services provider for the provision of a pilot for flights on the aircraft owner's aircraft to transport employees of the aircraft owner's business to business meetings. The flights constitute taxable transportation, as that term is defined in section 4262(a), and no exemptions (other than section 4261(e)(5)) apply. During the first calendar quarter of 2020, the pilot provides 200 flight hours of service on the aircraft owner's aircraft and 50 hours of service on a substitute aircraft.

(ii) Analysis. The tax imposed by section 4261(a) applies on a pro rata basis to the pilot's flight hours on a substitute aircraft. The allocation is calculated by applying to the \$3,000 total amount paid (3 months x \$1,000 monthly fee) by the aircraft owner to the aircraft management services provider during the calendar quarter the ratio of: 50 (the total pilot flight hours provided on substitute aircraft during the calendar quarter) over 250 (the sum of the total pilot flight hours on the aircraft owner's aircraft during the calendar quarter and the total pilot flight hours provided on substitute aircraft during the calendar quarter). The computation is as follows: $\$3,000 \times (50/250) = \600 (amount subject to tax). The portion of the amount paid that is exempt from the section 4261 taxes by application of section

4261(e)(5) is \$2,400. The portion of the amount paid that is subject to the tax imposed by section 4261(a) is \$600. The tax imposed by section 4261(b) also applies to amounts paid for flights on substitute aircraft on a per-passenger basis. See §49.4261-2(b) for rules regarding the application of the tax imposed by section 4261(b).

(2) Example 2--(i) Facts. An aircraft owner pays a monthly fee to an aircraft management services provider for aircraft management services related to the aircraft owner's aircraft. When the aircraft is not being used by the owner, the owner sometimes permits a charter company to use the aircraft for charter flights. At other times when the aircraft is not being used by the owner, the owner permits a tour operator to use the aircraft for flightseeing tours. All charter and flightseeing flights on the aircraft constitute taxable transportation, as that term is defined in section 4262(a), and no exemptions (other than section 4261(e)(5)) apply. The aircraft's maximum certificated takeoff weight is 7,000 pounds and the aircraft uses kerosene as fuel.

(ii) Analysis. Amounts paid by the aircraft owner to the aircraft management services provider for aircraft management services related to the aircraft owner's own aircraft are exempt under section 4261(e)(5). Amounts paid by the charterer or passengers for the charter flights are subject to tax under section 4261(a) and (b). See §49.4261-7(h) for rules relating to the application of the tax imposed by section 4261 on amounts paid for charter flights. See §49.4261-2(b) for rules regarding the application of the tax imposed by section 4261(b). Amounts paid by flightseeing customers for flightseeing tours are also subject to tax under section 4261(a) and (b). If a payment for a flightseeing tour includes charges for nontransportation services, the charges for the nontransportation services may be excluded in computing the tax payable provided the payments are separable and provided in exact amounts. See §49.4261-2(c). The kerosene used as fuel on the charter flights and the flightseeing flights is subject to the tax imposed by section 4081(a) at the commercial rate.

(k) Applicability date. This section applies on and after the later of [date these regulations are published as final regulations in the **Federal Register**] or January 1, 2021.

§49.4262(a)-1 [Redesignated]

Par. 14. Section 49.4262(a)-1 is redesignated as §49.4262-1.

Par. 15. Newly redesignated §49.4262-1 is amended by:

1. In paragraph (a) introductory text, removing “section 4262(b) (see §49.4262(b)-1)” and adding “section 4262(b) of the Internal Revenue Code (Code) (see §49.4262-2)” in its place.
2. In the first sentence of paragraph (a)(1), removing “Transportation” and adding “Transportation by air” in its place.
3. In the first sentence of paragraph (a)(1), removing “(the “225-mile zone”)” and adding “(225-mile zone)” in its place.
4. Revising paragraphs (a)(2) and (b)(2).
5. In paragraph (b), removing “subparagraphs (1) and (5) of this paragraph” and adding “paragraph (b)(1) and (5) of this section” in its place.
6. In paragraph (b), removing “subject to the tax” and adding “subject to the taxes imposed by section 4261(a) and (b)” in its place.
7. Removing and reserving paragraph (c).
8. Revising introductory paragraph (d); designating Example (1) as paragraph (d)(1) and revising new paragraph (d)(1) Example 1.
9. In paragraph (d), designating Example (2) as (d)(2) and removing and reserving newly designated paragraph (d)(2) Example 2.
10. In paragraph (d), designating Example (3) as paragraph (d)(3) and removing “6 hours” wherever it appears and adding “12 hours” in its place and also removing “subject to tax” wherever it appears and adding “subject to the taxes imposed by section 4261(a) and (b)” in its place.
11. In paragraph (d), designating Example (4) as paragraph (d)(4), and removing “six hours” wherever it appears and adding “12 hours” in its place and also removing

“subject to tax” wherever it appears and adding “subject to the taxes imposed by section 4261(a) and (b)” in its place.

12. Revising paragraph (e).

13. Adding paragraph (f).

The revisions and addition read as follows:

§49.4262-1 Taxable transportation.

(a) * * *

(2) In the case of any other transportation by air, that portion of such transportation that is directly or indirectly from one port or station in the United States to another port or station in the United States, but only if such transportation is not part of uninterrupted international air transportation within the meaning of section 4262(c)(3) of the Code and §49.4262-3(c). Transportation from one port or station in the United States occurs whenever a carrier, after leaving any port or station in the United States, makes a regularly scheduled stop at another port or station in the United States irrespective of whether stopovers are permitted or whether passengers disembark.

* * * * *

(b) * * *

(2) New York to Vancouver, Canada, with a stop at Toronto, Canada;

* * * * *

(d) Examples. The following examples illustrate the application of section 4262(a)(2) and the taxes imposed by section 4261(a) and (b) of the Code:

(1) Example (i). A purchases in New York a ticket for air transportation from New York to Nassau, Bahamas, with a scheduled stopover of 14 hours in Miami. The part of the transportation from New York to Miami is taxable transportation as defined in section 4262(a) because such transportation is from one station in the

United States to another station in the United States and the trip is not uninterrupted international air transportation (because the scheduled stopover interval in Miami is greater than 12 hours). Therefore, the amount paid for the transportation from New York to Miami is subject to the taxes imposed by section 4261(a) and (b).

* * * * *

(e) Examples of transportation that is not taxable transportation. The following examples illustrate transportation that is not taxable transportation:

(1) New York to Trinidad with no intervening stops;

(2) Minneapolis to Edmonton, Canada, with a stop at Winnipeg, Canada;

(3) Los Angeles to Mexico City, Mexico, with stops at [Tijuana](#) and Guadalajara, Mexico;

(4) New York to Whitehorse, Yukon Territory, Canada, by air with a scheduled stopover in Chicago of five hours. Amounts paid for the transportation referred to in examples set forth in paragraphs (e)(1), (2), and (3) of this section are not subject to the tax regardless of where payment is made, since none of the trips:

(i) Begin in the United States or in the 225-mile zone and end in the United States or in the 225-mile zone, nor

(ii) Contain a portion of transportation which is directly or indirectly from one port or station in the United States to another port or station in the United States. The amount paid within the United States for the transportation referred to in the example set forth in paragraph (4) of this section is not subject to tax since the entire trip (including the domestic portion thereof) is “uninterrupted international air transportation” within the meaning of [section 4262\(c\)\(3\)](#) and paragraph (c) of [§49.4262-3](#). In the event

the transportation is paid for outside the United States, no tax is due since the transportation does not begin and end in the United States.

* * * * *

(f) Applicability date. This section applies on and after the later of [date these regulations are published as final regulations in the **Federal Register**] or January 1, 2021. For rules that apply before that date, see 26 CFR part 49, revised as of April 1, 2020.

§49.4262(b)-1 [Redesignated]

Par. 16. Section 49.4262(b)-1 is redesignated as §49.4262-2.

§49.4262-2 [Amended]

Par. 17. Newly redesignated §49.4262-2 is amended as follows:

1. In paragraph (a), “section 4262(b)” is removed and “section 4262(b) of the Internal Revenue Code” is added in its place.
2. In paragraph (b)(2), Example (2) is removed and reserved.
3. Revise paragraph (d). “Illustration” and add “Example” in its place.

The revisions and additions reads as follows:

§49.4262-2 Exclusion of certain travel.

* * * * *

(d) Example. The application of paragraph (c) of this section may be illustrated by the following example: A purchases in San Francisco a ticket for transportation by air to Honolulu, Hawaii. The portion of the transportation which is outside the continental United States and is outside Hawaii is excluded from taxable transportation. The tax

applies to that part of the payment made by A which is applicable to the portion of the transportation between the airport in San Francisco and the three-mile limit off the coast of California (a distance of 15 miles) and between the three-mile limit off the coast of Hawaii and the airport in Honolulu (a distance of 5 miles). The part of the payment made by A which is applicable to the taxable portion of his transportation and the tax due thereon are computed in accordance with paragraph (c)(1) as follows:

Mileage of entire trip (San Francisco airport to Honolulu airport) (miles).....	2,400
Mileage in continental United States (miles).....	15
Mileage in Hawaii (miles).....	5
	20
Fare from San Francisco to Honolulu.....	\$168.00
Payment for taxable portion (20/2400 x \$168).....	\$1.40
Tax due (7.5% (rate in effect on date of payment) x \$1.40)...	\$0.11

(All distances and fares assumed for purposes of this example. This example only addresses the computation of the tax imposed by section 4261(a). It does not address the computation of any other tax imposed by section 4261 that may apply to these facts.)

§49.4262(c)-1 [Redesignated]

Par. 18. Section 49.4262(c)-1 is redesignated as §49.4262-3.

Par. 19. Newly redesignated §49.4262-3 is amended as follows:

1. In the first sentence of paragraph (a), remove “includes only the 48 States existing on July 25, 1956 (the date of the enactment of the Act of July 25, 1956 (Pub. L. 796, 84th Cong., 70 Stat. 644) and the District of Columbia” and add “means the District of Columbia and the States other than Alaska and Hawaii” in its place.

2. In paragraph (a), the last sentence is removed.

3. In paragraph (c), remove “six hours” wherever it appears and add “12 hours” in its place.

4. In paragraph (c), remove “6 hours” wherever it appears and add “12 hours” in its place.

5. In paragraph (c), remove “six-hour” wherever it appears and add “12-hour” in its place.

6. In paragraph (c)(2), remove “paragraph (a)(2) of §49.4264(c)-1” and add “§49.4263-3(a)(2)” in its place.

7. Adding paragraphs (d) and (e).

The additions read as follows:

§49.4262-3 Definitions.

* * * * *

(d) Transportation. For purposes of the regulations in this subpart, the term transportation includes layover or waiting time and movement of the aircraft in deadhead service.

(e) Applicability date. This section applies on and after the later of [date these regulations are published as final regulations in the **Federal Register**] or January 1,

2021. For rules that apply before that date, see 26 CFR part 49, revised as of April 1, 2020.

§49.4263-5 [Redesignated]

Par. 20. Section 49.4263-5 is redesignated as §49.4281-1.

Par. 21. Newly redesignated §49.4281-1 is amended by:

1. Revising paragraphs (a) and (b).
2. In paragraph (c), adding a sentence at the end of the paragraph.
3. Adding paragraphs (d) and (e).

The revisions and additions read as follows:

§49.4281-1 Small aircraft on nonestablished lines.

(a) In general. Amounts paid for the transportation of persons on a small aircraft of the type sometimes referred to as air taxis shall be exempt from the tax imposed under section 4261 of the Internal Revenue Code provided the aircraft has a maximum certificated takeoff weight of 6,000 pounds or less determined as provided in paragraph (b) of this section. The exemption does not apply, however, when the aircraft is operated on an established line or when the aircraft is a jet aircraft.

(b) Maximum certificated takeoff weight. The term maximum certificated takeoff weight means the maximum certificated takeoff weight shown in the type certificate or airworthiness certificate issued by the Federal Aviation Administration.

(c) * * * An aircraft is not considered as 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.

(d) Jet aircraft. For purposes of this section, the term jet aircraft does not include any aircraft which is a rotorcraft (such as a helicopter) or propeller aircraft.

(e) Applicability date. This section applies on and after the later of [date these regulations are published as final regulations in the **Federal Register**] or January 1, 2021. For rules that apply before that date, see 26 CFR part 49, revised as of April 1, 2020.

§49.4264(a)-1 [Redesignated]

Par. 22. Section 49.4264(a)-1 is redesignated as §49.4263-1.

Par. 23. Newly redesignated §49.4263-1 is revised to read as follows:

§49.4263-1 Duty to collect the tax; payments made outside the United States.

Where payment upon which tax is imposed by section 4261 of the Internal Revenue Code is made outside the United States for a prepaid order, exchange order, or similar order, the person furnishing the initial transportation pursuant to such order shall collect the applicable tax. See section 4291 and the regulations thereunder for cases where persons receiving payment must collect the tax.

§49.4264(b)-1 [Redesignated]

Par. 24. Section 49.4264(b)-1 is redesignated as §49.4263-2.

§49.4263-2 [Amended]

Par. 25. Newly redesignated §49.4263-2 is amended as follows:

1. In the first sentence of paragraph (a), remove “4264(b)” and add “4263(b) of the Internal Revenue Code (Code)” in its place.

2. In the last sentence of paragraph (a), remove “office of the district director for the district in which the person making the report is located,” and add “Commissioner” in its place.

3. In paragraph (b), add “of the Code” at the end of the paragraph.

4. In paragraph (c), remove “Illustration.” and add “Example.” in its place.

5. In the last sentence of paragraph (c), remove “office of the district director of internal revenue for the district in which the carrier is located,” and add in its place “Commissioner”.

§49.4264(c)-1 [Redesignated]

Par. 26. Section 49.4264(c)-1 is redesignated as §49.4263-3.

Par. 27. Newly redesignated §49.4263-3 is amended by:

1. Removing “a district director” wherever it appears and adding “Commissioner” in its place.

2. Revising paragraph (a).

3. In paragraph (b), removing the second sentence.

4. In paragraph (b), removing “4264” wherever it appears and adding “4263” in its place.

5. In paragraph (b), add “of the Code” after “4291”.

6. Removing and reserving paragraph (c).

The revisions read as follows:

§49.4263-3 Special rule for the payment of tax.

(a) In general--(1) For the rules applicable under section 4263(c) of the Internal Revenue Code, see §49.4261-1(b).

* * * * *

§49.4264(d)-1 [Redesignated]

Par. 28. Section 49.4264(d)-1 is redesignated as §49.4263-4.

§49.4263-4 [Amended]

Par. 29. Newly redesignated §49.4263-4 is amended by removing “4264(d)” and adding “4263(d)” in its place.

§49.4264(e)-1 [Redesignated]

Par. 30. Section 49.4264(e)-1 is redesignated as §49.4263-5.

§49.4264(f)-1 [Redesignated]

Par. 31. Section 49.4264(f)-1 is redesignated as §49.4263-6.

§49.4263-6 [Amended]

Par. 32. Newly redesignated §49.4263-6 is amended by removing and reserving paragraph (b).

Par. 33. In § 49.4271-1, revise paragraphs (a) and (b) to read as follows:

§49.4271-1 Tax on transportation of property by air.

(a) Purpose of this section. Section 4271 of the Internal Revenue Code (Code) imposes a 6.25% tax on amounts paid within or without the United States for the taxable

transportation of property (as defined in section 4272). This section sets forth rules as to the general applicability of the tax. This section also sets forth rules authorized by section 4272(b)(2) of the Code which exempt from tax payments for the transportation of property by air in the course of exportation (including shipment to a possession of the United States) by continuous movement, and in due course so exported.

(b) Imposition of tax. (1) The tax imposed by section 4271 applies only to amounts paid to persons engaged in the business of transporting property by air for hire.

(2) The tax imposed by section 4271 does not apply to amounts paid for the transportation of property by air if such transportation is furnished on an aircraft having a maximum certificated takeoff weight (as defined in section 4281(b) of the Code) of 6,000 pounds or less, unless such aircraft is operated on an established line or when such aircraft is a jet aircraft. The tax imposed by section 4271 also does not apply to any payment made by one member of an affiliated group (as defined in section 4282(b) of the Code) to another member of such group for services furnished in connection with the use of an aircraft if such aircraft is owned or leased by a member of the affiliated group and is not available for hire by persons who are not members of such group.

* * * * *

Par. 34. Section 49.4271-2 is added to read as follows:

§49.4271-2 Aircraft management services.

For rules regarding the exemption for certain amounts paid by aircraft owners for aircraft management services, see §49.4261-10.

§49.4282-1 [Reserved]

Par. 35. Add and reserve §49.4282-1.

Sunita Lough,

Deputy Commissioner for Services and Enforcement.

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