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JANUARY 02, 2001

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

Chief,

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification Number:

Taxable Periods:

Date of Conference:

Legend:

X =

Y =

x =

ISSUE:

Are amounts paid by Y to X, a limited liability company, exempt from the tax imposed by § 4261 of the Internal Revenue Code as payments between members of an affiliated group for purposes of § 4282?

CONCLUSION:

Because X is an entity properly classified as a partnership, amounts paid by Y to X are not payments between members of an affiliated group for purposes of § 4282. Rather, those amounts are subject to the tax imposed by § 4261.

FACTS:

X, a Virginia limited liability company (LLC), was formed on date x by corporation Y and two of the officer/shareholders of Y. Y contributed an aircraft and received a 99 percent interest in X. The two officer/shareholders each contributed approximately

\$3,000 and received a .5 percent interest in X. X owns the aircraft, hires pilots, and pays to have the aircraft maintained. Y pays X a monthly amount that is determined by projecting the amount necessary to maintain and operate the aircraft based on prior experience. The only income of X is the amount paid by Y for the expense of operating the aircraft. The air transportation provided by X begins and ends in the United States.

APPLICABLE LAW:

Section 4261(a) imposes a tax on the amount paid for taxable transportation (as defined in § 4262) of any person by air.

Section 4262(a)(1) in part defines the term "taxable transportation" as transportation by air which begins in the United States and ends in the United States. Section 4262(d) clarifies that the term "transportation" includes layover or waiting time as well as movement of the aircraft in deadhead service.

Section 4282(a) provides that the tax imposed by § 4261 does not apply to amounts paid by one member of an affiliated group to another member of that group for air transportation if the aircraft is not available for hire by persons other than members of the affiliated group.

Section 4282(c) provides that, for purposes of § 4282, the term "affiliated group" has the meaning assigned by § 1504(a), except that all corporations shall be treated as includible corporations, without regard to the exclusions set forth in § 1504(b).

Section 4291 requires any person receiving any payment for taxable services (such as taxable air transportation) to collect the amount of the tax from the person making the payment.

Section 1504(a) provides generally that the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent. In general, at least 80 percent of stock, by both voting power and value, must be owned by the parent or by another corporation in the chain.

Section 1504(b) defines "includible corporation" to mean any corporation except those exempt from taxation under § 501, insurance companies, foreign corporations, those with respect to which an election under § 936 is in effect, regulated investment companies, real estate investment trusts, a DISC, and an S corporation.

Section 301.7701-3(a) provides that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8)(an "eligible entity") can elect its classification for federal tax purposes. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under § 301.7701-2(b)(2)) or a partnership. These regulations were effective beginning on January 1, 1997.

Under § 301.7701-3(b)(3), unless an entity elects otherwise, an eligible entity in existence prior to January 1, 1997, will have the same classification that the entity claimed under §§ 301.7701-1 through 301.7701-3 as in effect prior to January 1, 1997.

Prior to January 1, 1997, § 301.7701-1(b) provided that the tests or standards to be applied in determining the classification in which an organization belongs (whether the entity is an association, partnership, trust, or other taxable entity) were set forth in former §§ 301.7701-2 through 301.7701-4. Under former § 301.7701-2(a)(1), the term “association” refers to an organization whose characteristics require it to be classified for purposes of taxation as a corporation rather than another type of organization, such as a partnership. Six characteristics ordinarily found in a pure corporation, taken together, distinguish it from other organizations. These characteristics are:

- (i) associates,
- (ii) an objective to carry on business and divide the gains therefrom,
- (iii) continuity of life,
- (iv) centralization of management,
- (v) liability for corporate debts limited to corporate property, and
- (vi) free transferability of interests.

An organization will be treated as an association if the corporate characteristics are such that the organization more nearly resembles a corporation than a partnership.

RATIONALE:

As an initial matter, we note that X is providing air transportation to Y, not merely leasing an aircraft. X owns and maintains the aircraft, and employs one or more pilots to operate the aircraft and has all elements of possession, command, and control. While Y or the officer/shareholders of Y determine the schedule and destination of each of the flights by the aircraft, this fact is not material for purposes of determining possession, command, and control. Rev. Rul. 76-431, 1976-2 C.B. 328. The air transportation provided by X constitutes taxable transportation as defined in § 4262(a)(1). Thus, the payments by Y to X are subject to the tax imposed by § 4261 unless exempted by the affiliated group exemption set forth in § 4282.

In order for a payment for otherwise taxable air transportation to meet the § 4282 exemption, the payment must be between members of an affiliated group, as defined in § 1504(a), without regard to the exclusions set forth in § 1504(b). That section requires that the members of the affiliated group be includible corporations meeting certain specified common stock ownership requirements. The term “includible corporations” is defined to include most types of corporations, with certain exceptions specified in § 1504(b).

Revenue Ruling 93-5, 1993-1 C.B. 227, states that Virginia limited liability companies have associates and an objective to carry on business and divide the gains therefrom, but lack the four remaining corporate characteristics. Because Virginia

limited liability companies lack those characteristics, Rev. Rul. 93-5 holds that Virginia limited liability companies are classified as partnerships for federal tax purposes for those periods prior to January 1, 1997. Thus, X is classified as a partnership for federal tax purposes for all periods prior to January 1, 1997.

Effective January 1, 1997, Section 301.7701-3(a) provides that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8)(an “eligible entity”) can elect its classification for federal tax purposes. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under § 301.7701-2(b)(2)) or a partnership. However, under § 301.7701-3(b)(3), unless an entity elects otherwise, an eligible entity in existence prior to January 1, 1997, will have the same classification that the entity claimed under §§ 301.7701-1 through 301.7701-3 as in effect prior to January 1, 1997. For the periods at issue here, X did not file an election to be classified as an association. Thus, X remained classified as a partnership for federal tax purposes for all periods at issue.

There is no provision in the Code that allows an entity properly classified as a partnership for federal tax purposes under either the entity classification regulations in effect prior to January 1, 1997, or the regulations that became effective on January 1, 1997, to be classified as a corporation for purposes of § 1504. Because X is not a corporation, it cannot be a member of an affiliated group as defined in § 1504(a). Thus, payments to X cannot be exempt from the tax imposed by § 4261 by reason of the exemption set forth in § 4282(a).

CAVEAT:

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent. Under § 6110(c), names, addresses, and identifying numbers have been deleted.