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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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CC:TEGE:EOEG:ET2
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Date:
November 01, 2006

TY:

Legend

Corporation =

X =

Year 1 =

Year 2 =

Dear :

This is in response to your request, dated May 12, 2006, for a letter ruling concerning the following two issues:

(1) Whether X's reimbursement to the Corporation in the amount equal to Treasury Regulation § 1.132-5(m)(4)'s "safe harbor airfare" for personal flights taken by X and X's spouse on the Corporation's aircraft for two years following X's resignation from the Corporation as its Chairman and CEO, is includible in X's gross income and thus, subject to information reporting under Internal Revenue Code ("Code") § 6041; and

(2) Whether the Corporation is responsible for collecting and paying over to the government the § 4261 tax on amounts paid by X to the Corporation for certain transportation by air.

FACTS

The Corporation owns and maintains several aircraft, each of which has a certificated takeoff weight in excess of 25,000 pounds. The aircraft are generally used by the Corporation's officers, directors, senior executives, and their guests primarily for business purposes. In situations where the Corporation's aircraft is used for an employee's personal use, the Corporation includes an amount in the employee's wages for income tax, employment tax, and reporting purposes. The amount the Corporation includes in an employee's wages is based on a special valuation rule commonly used for non-commercial flights. See, Treasury Regulation (Treas. Reg.) § 1.61-21(g).

You represent that the Corporation values personal flights provided to its Chairman and President, and their respective families, at a rate reduced from the special rate commonly used to value non-commercial flights ("safe harbor airfare"). See, Treas. Reg. § 1.132-5(m). You further represent that the resulting safe harbor airfare amounts are reported as wages on the Chairman's and President's respective Forms W-2 for the years in which the flights occurred.

X resigned from the Corporation as its Chairman and CEO. Upon X's resignation, X and the Corporation entered into a services agreement ("the agreement"). According to the terms of the agreement, X will provide consulting services to the Corporation for Year 1. The terms of the agreement also represent that X will act as an independent contractor during the Year 1. The agreement further provides that the Corporation, based on an independently-conducted security risk assessment, will provide X with certain protective services; including X and X's spouse's personal use of the Corporation's aircraft for domestic and international travel. The Corporation will provide X with these protective services for Years 1 and 2. You represent that X agreed to reimburse the Corporation an amount equal to the safe harbor airfare for the personal flights taken by X and X's spouse for the duration of the agreement.

The Corporation and X structured a lease agreement ("the lease") to govern X's use of the Corporation's aircraft. Under the terms of the lease, the Corporation provides a flight crew and maintains operational control of all transportation, while X agrees to reimburse the Corporation an amount for each use of the aircraft, determined by the safe harbor airfare under Treasury Regulation § 1.132-5(m). The Corporation is responsible for all maintenance and pays all expenses related to the operation of the aircraft. X provides the Corporation with transportation requests, including destination, date and time of departure and return flights, and the number of anticipated passengers and the Corporation will use reasonable efforts to accommodate X's requests.

LAW AND ANALYSIS

A. Safe Harbor Airfare Fringe Benefit

Section 61 of the Code provides that gross income includes compensation for services, such as fees, commissions, fringe benefits, and similar items. A fringe benefit is included in the income of the person performing the services in connection with which the fringe benefit is furnished. Treas. Reg. § 1.61-21(a)(3). Thus, a fringe benefit may be taxable to a person even though that person did not actually receive the fringe benefit. Id. The portion of the fringe benefit that an employee must include in gross income, is the amount by which the fair market value of the fringe benefit exceeds the sum of: 1) the amount, if any, paid for the benefit by or an behalf of the recipient; and 2) the amount, if any, specifically excluded from gross income by some other section of subtitle A of the Internal Revenue Code. Treas. Reg. § 1.61-21(b)(1).

In general, a fringe benefit's fair market value is the amount that an individual would have to pay for the particular benefit in an arm's-length transaction. Treas. Reg. § 1.61-21(b)(2). However for certain fringe benefits, special valuation rules may be used for income tax, employment tax,[1] and reporting purposes. Treas. Reg. § 1.61-21-(c)(2)(B)(ii). The employer has the option to use any of the special valuation rules. Id. If a special valuation rule is used, it must be used for all purposes. Id.

Treasury Regulation § 1.61-21(g) provides the special valuation rule for personal flights provided to employees on employer-provided aircraft. A personal flight is a flight that is taken for personal purposes and is therefore not excludable as a "working condition fringe" under section 132(d) of the Internal Revenue Code. Treas. Reg. § 1.61-21(g)(4)(i). If an employer values a single flight using the special valuation rule, then it must value all flights provided to all employees during the calendar year according to the special valuation rule.[2] Treas. Reg. § 1.61-21(g)(14).

Under the special valuation rule, the value of a personal flight is determined under the base aircraft valuation formula, a.k.a. the Standard Industry Fare Level formula, ("SIFL"). Treas. Reg. § 1.61-21(g)(5). The SIFL formula consists of multiplying the

[1] Under Chapters 21, 23, and 24 of Subtitle C of the Code, employment taxes consists of the Federal Insurance Contributions Act tax ("FICA"), the Federal Unemployment Tax Act tax ("FUTA"), and the Collection of Income Tax at the Source on Wages ("income tax withholding"), respectively.

[2] However, an employer may choose to value personal flights provided employees, who qualify as "specified individuals" under Code § 274(e)(2)(B)(ii), in accordance with the general valuation rules under Treasury Regulation § 1.61-21(b)(6). See, Notice 2005-45, 2005-24 I.R.B. 1228. Such valuation is permitted, even if, an employer values personal flights provided to all other employees in accordance with the special valuation rule under Treasury Regulation § 1.61-21(g). See, id. In such limited circumstances, Treasury Regulation 1.61-21(g)(14)'s consistency requirement will not be violated. See, id.

SIFL cents-per-mile rate applicable for the period during which the flight was taken by the appropriate aircraft multiple, and then subsequently adding the applicable terminal charge to such total. Id. The SIFL cents-per-mile rates and the terminal charge are each calculated by the Department of Transportation, and they are revised semi-annually. Id. The aircraft multiple, on the other hand, is determined by two factors: 1) the weight of the employer-provided aircraft; and 2) whether the employee receiving the benefit qualifies as either a "control employee" or "non-control employee". Treas. Reg. § 1.61-21(g)(7).

A "control employee" is an employee who is either: 1) a Board- or shareholder-appointed, confirmed, or elected officer of the employer (however, limited to the lesser of one-percent of all employees, or ten employees); 2) among the top one percent most highly-paid employees of the employer (limited to a maximum of 50 employees); 3) an owner of a five-percent or greater equity, capital, or profits interest in the employer; or 4) a director of the employer. Treas. Reg. § 1.61-21(g)(8)(i). A former employee, who qualified as a control employee at any time after either reaching the age of 55, or within three years of separation from the service of the employer, is also considered a control employee with respect to valuing personal flights. Treas. Reg. § 1.61-21(g)(11). In addition, personal flights provided to a control employee's spouse are treated as personal flights provided to the control employee. Treas. Reg. § 1.61-21(g)(7)(ii).

If a "bona fide business-oriented security concern" exists with respect to a particular employee for which an employer requires that the employee travel on employer-provided aircraft for personal trips, then the employer may exclude from the employee's gross income, as a working condition fringe, the excess value of the aircraft trip over the "safe harbor airfare". Treas. Reg. § 1.132-5(m)(4). In order for a person to benefit from the working condition fringe exclusion, they must qualify as an "employee" within the meaning of Treasury Regulation § 1.132-1(b)(2). Under Treasury Regulation § 1.132-1(b)(2), "employee" means: 1) any individual who is currently employed by the employer; 2) any partner who performs services for the partnership; 3) any director of the employer; and 4) any independent contractor who performs services for the employer. If it is ultimately determined that a bona fide business-oriented security concern exists with respect to an "employee", then such a security concern is deemed to exist with respect to the employee's spouse and dependents, who concurrently travel with the employee on personal flights. Treas. Reg. § 1.132-5(m)(3)(ii).

A "bona fide business-oriented security concern" exists only if the facts and circumstances establish a specific basis for concern regarding the safety of the employee. Treas. Reg. § 1.132-5(m)(2)(i). No bona fide business-oriented security concern will exist unless the employer establishes to the satisfaction of the Commissioner of Internal Revenue that an "overall security program" has been provided with respect to the employee involved. Treas. Reg. § 1.132-5(m)(2)(ii). An "overall security program" is one in which security is provided to protect the employee on a 24-hour basis. Treas. Reg. § 1.132-5(m)(2)(iii). However, an overall security program will

be deemed to exist in situations where the employer conducts and implements an "independent security study" with respect to the employee. Treas. Reg. § 1.132-5(m)(2)(iv). An "independent security study" will exist if each of the following are met: 1) a security study is performed with respect to the employer and the employee by an independent security consultant; 2) the security study is based on an objective assessment of all facts and circumstances; 3) the recommendation of the security study is that an overall security program is not necessary and the recommendation is reasonable under the circumstances; and 4) the employer applies the specific security recommendations contained in the security study to the employee on a consistent basis. Treas. Reg. § 1.132-5(m)(2)(iv).

Once it is determined that a bona fide business-oriented security concern exists, then the "safe harbor airfare" has to be calculated. The safe harbor airfare is determined by using the non-commercial flight valuation rule under Treasury Regulation § 1.61-21(g), whereby a 200-percent aircraft multiple is used in the SIFL formula, ("200% SIFL rate"). Treas. Reg. § 1.132-5(m)(4). The value of the safe harbor airfare must be included in the employee's gross income (to the extent not reimbursed by the employee) regardless of whether the employer generally uses the special valuation rule under Treasury Regulation § 1.61-21(g). Id. The excess value of the personal aircraft trip over this safe harbor airfare amount can be excluded from the employee's gross income as a working condition fringe. Id.

In the present situation, X and X's spouse use the Corporation's aircraft for personal flights. Generally, a personal flight provided by an employer to a worker constitutes gross income (assuming the employer is not reimbursed), which is not subject to an exclusion from gross income as a working condition fringe. Since you represent that the Corporation values all personal flights given to employees in accordance with the special valuation rule under Treasury Regulation § 1.61-21(g), then all flights provided to X and X's spouse will also be valued in accordance with this special valuation rule. See, Treas. Reg. § 1.61-21(g)(14).

According to the special valuation rule, X and X's spouse qualify as control employees. See, Treas. Reg. §§ 1.61-21(g)(7)(ii), (8)(i), and (11). Thus based on X and X's spouse's statuses as control employees, coupled with your representation that each of the Corporation's aircraft weighs in excess of 25,000 lbs., the value of any taxable fringe benefit to X is based on applying a 400-percent aircraft multiple in the SIFL formula, ("400% SIFL rate"). See, Treas. Reg. § 1.61-21(g)(7)(ii).

However, you have sufficiently illustrated that an overall security program was created due to a bona fide business-oriented security concern for X's safety. This overall security program was established and implemented after the Corporation obtained an independent security and risk assessment study from an independent security consultant with respect to X. Such study meets all the requirements of an independent security study set forth in Treasury Regulation § 1.132-5(m)(2)(iv). Therefore, due to

the existence of such overall security program, the Corporation can value X's personal flights in accordance with the safe harbor airfare, which uses the 200% SIFL rate. See, Treas. Reg. § 1.132-5(m)(4). In addition, the Corporation can value X's spouse's personal flights, taken concurrently with X, at the safe harbor airfare. See, Treas. Reg. § 1.132-5(m)(3)(ii). The excess value of the personal flights is excludable from X's gross income as a working condition fringe. See, Treas. Reg. § 1.132-5(m)(4).

However, X will only be able to exclude the excess value of the personal flights over the safe harbor airfare as a working condition fringe so long as X qualifies as an "employee" under Treasury Regulation § 1.132-1(b)(2). For Year 1, the agreement provides that X will provide consulting services to the Corporation as an independent contractor. An independent contractor qualifies as "employee" for purposes of receiving a working condition fringe under Code § 132(d). See, Treas. Reg. § 1.132-1(b)(2)(iv). Thus for Year 1, the period of time X provides consulting services to the Corporation, X is able to benefit from the safe harbor airfare valuation under Treasury Regulation § 1.132-5(m)(4). Moreover, X agreed to reimburse the Corporation in an amount equal to the safe harbor airfare for all personal flights provided to X and X's spouse during the course of the agreement. Thus, X incurs no gross income as a result of receiving personal flights on employer-provided aircraft for Year 1. See, Treas. Reg. § 1.61-21(b)(1). Therefore, the Corporation does not have to report any income attributable to X's personal air travel on an information return for Year 1.

With respect to personal flights taken in Year 2, however, X will not benefit from the safe harbor airfare valuation. According to the terms of the agreement, X does not provide any services to the Corporation during Year 2. Therefore, X fails to qualify as an employee for purposes of receiving the safe harbor airfare, a working condition fringe. See, 1.132-1(b)(2). As a consequence, the fringe benefit to X is valued according to the special valuation rule that the Corporation uses to value all personal flights given to employees on employer-provided aircraft. X's and X's spouse's statuses as control employees require that the personal flights be valued using the 400% SIFL rate. See, 1.61-21(g)(7), (8), and (11). Since X has agreed to reimburse the Corporation in amounts equal to the safe harbor airfare (200% SIFL rate), X incurs gross income attributable to the personal flights in an amount based on the difference between the 400% SIFL rate and the 200% SIFL rate. See, Treas. Reg. § 1.61-21(b)(1).

In addition, the above-mentioned amounts, which are includible in X's gross income for Year 2, also constitute "wages" for the same taxable period. Thus, these amounts are subject to employment taxes. See, Code §§ 3121(a)(20), 3306(b)(16), and 3401(a)(19). Such amounts constitute wages despite the fact that an employer-employee relationship no longer exists between X and the Corporation. See, Treas. Reg. §§ 31.3121(a)-1(i), 31.3306(b)-1(i), and 31.3401(a)-1(a)(5). The Corporation provided the personal flights to X and X's spouse in Year 2 as a result of X's prior employment relationship with the Corporation, and the flights are therefore part of the "entire employer-employee relationship for which compensation is paid to the employee by the employer." See,

Social Security Board v. Nierotko, 327 U.S. 358, 365-66 (1946). As a consequence, the Corporation must report the wages on a Form W-2, Wage and Tax Statement, pursuant to § 6051(a).

B. Excise Tax

Section 4261(a) of the Code imposes a percentage tax on the amount paid for taxable transportation of any person.

Section 4261(b) imposes a flat dollar tax on the amount paid for each domestic segment of taxable transportation by air (domestic segment tax).

Section 4262(a)(1) defines taxable transportation as including transportation by air that begins and ends in the United States or in that portion of Mexico or Canada that is not more than 225 miles from the nearest point in the continental United States.

Section 4261(c)(1) imposes a flat dollar tax on the amount paid for any transportation of any person by air, if such transportation begins or ends in the United States (international travel facilities tax). Section 4261(c)(2) provides an exception to § 4261(c)(1) if the transportation is entirely taxable under § 4261(a). Section 4261(c)(3) provides a special rate for flights beginning or ending in Alaska or Hawaii.

Section 4261(d) provides that these taxes are paid by the person making the payment subject to the tax and § 4291 provides that the tax is collected by the person receiving the payment ("the collector"). The collector, which is also responsible for paying over the tax to the government, is generally the carrier that provides the air transportation to the taxpayer. Under § 4263(c), if the tax is not paid at the time payment for transportation is made, then the carrier providing the initial segment is liable for the tax.

All amounts paid for air transportation service, including hourly, per diem, or monthly fees, are subject to the tax imposed by § 4261. Rev. Rul. 76-556, 1976-2 C.B. 354.

If the owner of an aircraft leases it to others for the transportation of persons but retains possession, command, and control of the aircraft, the owner is furnishing taxable transportation within the meaning of § 4261. However, if the owner of the aircraft transfers the complete possession, command, and control of the aircraft, the owner is not engaging in a taxable transportation service, but is merely leasing the aircraft. Rev. Rul. 60-311, 1960-2 C.B. 341.

If the owner of the aircraft employs the pilot and crew and provides their services with the aircraft, the owner is deemed to have the essential elements of possession, command, and control of the aircraft at all times, irrespective of the fact that the lessee may direct the pilot as to destination and other details concerning actual flights when using the aircraft. Rev. Rul. 76-394, 1976-2 C.B. 355.

The domestic segment tax is calculated by multiplying the amount of tax set forth in § 4261(b)(1) by the number of passengers transported on the aircraft per segment. Rev. Rul. 2002-34, 2002-1 C.B. 1150. The international travel facilities tax is similarly calculated on a per head basis. Rev. Rul. 72-309, 1972-1 C.B. 348.

The Corporation retains possession, command and control of the aircraft and is furnishing taxable transportation by air to X. Hence, amounts paid by X to the Corporation for the transportation described above are subject to tax under § 4261. The Corporation must collect the tax on these amounts under § 4291; X is liable for the tax under § 4261(d); and the Corporation is liable for the tax under § 4263(c) if it is not paid by X at the time payment for transportation is made.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Lynne Camillo
Branch Chief, Employment Tax Branch 2 (Exempt Organizations/Employment Tax/Government Entities)
(Tax Exempt & Government Entities)

cc: