

Part I

Section 4221.--Certain Tax-free Sales

26 CFR 48.4221-4: Tax-free sale of articles for use by the purchaser as supplies for vessels or aircraft. (Also §§ 4041, 4081, 4091, 4092, 6416, 6421, 6427, 7805; §§ 48.4041-10, 48.6416(b)(2)-2, 301.7805-1.)

Rev. Rul. 2002-50

ISSUE

For purposes of § 4092 of the Internal Revenue Code, when is an aircraft “actually engaged in foreign trade” within the meaning of § 4221(d)(3).

FACTS

Aircraft A, Aircraft B, and Aircraft C are operated by a domestic airline in the business of transporting persons by air for hire. The aviation fuel purchased for use in the aircraft is purchased in the United States.

Situation 1. Aircraft A flies from city #1 in the United States to city #3 in a foreign country. En route to city #3 Aircraft A stops in city #2 in the United States. The flight from city #1 to city #2 is designated Flight No. 111 and the flight from city #2 to city #3 is designated Flight No. 333. Aircraft A transports at least one person for hire from city #1 to city #3.

Situation 2. Aircraft B flies from city #4 in a foreign country to city #6 in the

United States. En route to city #6 Aircraft B stops in city #5 in the United States. The flight from city #4 to city #5 is designated Flight No. 555 and the flight from city #5 to city #6 is designated Flight No. 777. Aircraft B transports at least one person for hire from city #4 to city #6.

Situation 3. Aircraft C flies only within the United States. Aircraft C transports persons for hire from city #1 to city #2, some of whom will transfer to Aircraft A for its flight from city #2 to city #3 in a foreign country.

LAW AND ANALYSIS

Section 4092 provides that no tax is imposed under § 4091 on aviation fuel sold by a producer for use by the purchaser in a nontaxable use (as defined in § 6427(l)(2)(B)).

Section 6427(l)(2)(B) provides that the term “nontaxable use” means, in the case of aviation fuel, any use that is exempt from the tax imposed by § 4041(c)(1) other than by reason of a prior imposition of tax.

Section 4041(g)(1) provides that no tax is imposed under § 4041(c)(1) on any liquid sold for use or used as supplies for vessels or aircraft (within the meaning of § 4221(d)(3)).

Section 4221(d)(3) provides that the term “supplies for vessels or aircraft” includes fuel supplies, ships’ stores, sea stores, or legitimate equipment on vessels actually engaged in foreign trade or trade between the United States and any of its possessions. For purposes of the preceding sentence, the term “vessels” includes civil aircraft employed in foreign trade or trade between the United States and any of its possessions.

Section 48.4221-4(b)(2) of the Manufacturers and Retailers Excise Tax Regulations provides that the terms “fuel supplies” and “legitimate equipment” include all articles, materials, supplies, and equipment necessary for the navigation, propulsion, and upkeep of vessels actually engaged in foreign trade, even though such vessels may make intermediate stops in the United States.

Section 48.4221-4(b)(7) provides that the exemption relating to supplies for vessels or aircraft, with respect to aircraft not constituting equipment of the armed forces, extends to aircraft only when employed in foreign trade.

Section 48.4221-4(b)(8) provides that the term “trade” includes the transportation of persons or property for hire and the making of the necessary preparations for the transportation.

Rev. Rul. 69-259, 1969-1 C.B. 287, addresses the question of whether Plane No. 1 and Plane No. 2 are engaged in foreign trade within the meaning of § 4221(d)(3). Plane No. 1 flies from a city in the United States to a city in a foreign country with intermediate stops in the United States. The ruling holds that Plane No. 1 is engaged in foreign trade within the meaning of the statute and regulations even though it makes intermediate stops in the United States. Plane No. 2 flies only within the United States and carries passengers whose ultimate destinations are cities within the United States and other passengers with tickets to a city in a foreign country. The foreign bound passengers are transferred from Plane No. 2 to another airplane for completion of their flights. The ruling holds that Plane No. 2 cannot be considered engaged in foreign trade because, to be so engaged, the plane itself must travel to a foreign destination.

Section 4221(d)(3) defines the term supplies for vessels or aircraft as including fuel supplies on vessels actually engaged in foreign trade. Under § 48.4221-4(b)(8), the term trade includes the transportation of persons or property for hire. Thus, an aircraft is "actually engaged in foreign trade" when it is transporting any person for hire between the United States and a foreign country. Under § 48.4221-4(b)(2), once an aircraft is actually engaged in foreign trade the aircraft remains so engaged even though it makes intermediate stops in the United States.

Situation 1. When flying from city #1 to city #3, Aircraft A is actually engaged in foreign trade within the meaning of § 4221(d)(3) because at least one person is transported for hire on that aircraft from city #1 to city #3. The stop in city #2 is an intermediate stop in the United States and thus Aircraft A is actually engaged in foreign trade on the flight from city #1 to city #2. Accordingly, the aviation fuel used in the aircraft on the flight from city #1 to city #2 is used in a nontaxable use for purposes of § 4092. The change in the flight number from Flight No. 111 to Flight No. 333 does not affect the determination of whether the aircraft is actually engaged in foreign trade.

Situation 2. When flying from city #4 to city #6, Aircraft B is actually engaged in foreign trade within the meaning of § 4221(d)(3) because at least one person is transported for hire on that aircraft from city #4 to city #6. The stop in city #5 is an intermediate stop in the United States and thus Aircraft B is actually engaged in foreign trade on the flight from city #5 to city #6. Accordingly, the aviation fuel used in the aircraft on the flight from city #5 to city #6 is used in a nontaxable use for purposes of § 4092. The change in the flight number from Flight No. 555 to Flight No. 777 does not affect the determination of whether the aircraft is actually engaged in foreign trade.

Situation 3. Aircraft C is not engaged in foreign trade even though some of its passengers transfer to Aircraft A for transport to a foreign country because Aircraft C flies only within the United States.

HOLDING

For purposes of § 4092, an aircraft that flies a person for hire between the United States and a foreign country is actually engaged in foreign trade within the meaning of § 4221(d)(3). That aircraft is also actually engaged in foreign trade when flying that person from a city in the United States to another city in the United States as part of the transportation between the United States and the foreign country.

This holding applies equally with respect to: fuel used in foreign aircraft that meet the requirements of § 4221(e)(1); aviation fuel not used for a taxable purpose within the meaning of § 6427(l); gasoline sold for specified uses and resales within the meaning of § 6416(b)(2); and gasoline sold for certain exempt purposes within the meaning of § 6421(c). This ruling does not consider the application of §§ 4092 and 4221(d)(3) to charter flights and no inferences should be drawn from this ruling regarding such flights.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 69-259 is modified and superseded.

PROSPECTIVE APPLICATION

Pursuant to the authority provided by § 7805(b)(8), this revenue ruling will not apply before January 1, 2003.

DRAFTING INFORMATION

The principal author of this revenue ruling is Susan Athy of the Office of

Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Susan Athy on (202) 622-3130 (not a toll-free call).