INTERCHANGE AGREEMENTS

Applicable Federal Excise Taxes

IRS treatment of interchange agreements can be very involved, and they do not become any easier when aircraft operators try to optimize their aircraft's usage through an interchange agreement.

The Federal Aviation Regulations under FAR Part 91.501(c)(2) define an interchange agreement as: An arrangement whereby a person leases his airplane to another person in exchange for equal time, when needed, on the other person's airplane and no charge, assessment or fee is made, except that a charge may be made not to exceed the difference between the cost of owning, operating and maintaining the two airplanes.

As with a number of situations, the FAA and the IRS are not necessarily in agreement with each other in their opinions on whether an interchange agreement is noncommercial or commercial transportation. The FAA allows an interchange agreement to be conducted under FAR Part 91. Therefore, for FAA purposes, as long as the truth-in-leasing requirements of FAR 91.23 are met, an interchange agreement is considered noncommercial transportation.

However, the IRS considers this type of operation commercial. It does not matter that there is not a profit motive or a profit made, the fact of the matter is that the aircraft has been made available for compensation or hire and the amounts paid for this activity are subject to the 7.5 percent (7.5%) commercial transportation ticket tax, plus a $5.30 *(as of 1/1/2026, adjusted annually)* per person per leg segment fee.

The following is a sample interchange scenario and the applicable federal excise taxes:

- **Scenario:** Company A owns and operates an aircraft to transport persons on corporate business. This company plans to enter into an aircraft interchange agreement with an unrelated company, who will be referred to as Company B. The agreement will allow Company A to use Company B's aircraft, including its flight crew, on an as-available basis, in exchange for allowing Company B to use Company A's aircraft, including its flight crew, on an as-available basis. Each company will bear the costs and expenses of operating its' own aircraft. Out-of-pocket expenses, not directly related to the operation of the aircraft, will be borne by the corporation using the aircraft.
- This scenario brings about two questions
  - *Does the commercial transportation tax apply to the use of the aircraft under the agreement?*
  - *If the tax does apply, what is the base upon which the tax is to be computed?*
- **IRS Rules:** The general approach to aviation excise taxes is to have the use of the aircraft subject to either (1) the taxes on transportation of persons or property or (2) to fuel taxes, but not to both taxes for any one trip. The tax imposed by Section 4261 of the IRS Code applies to the amounts paid for air transportation to a person who has possession, command and control of the aircraft *(IRS Private Letter Ruling 9022011 find Rev Ruling).*
- In this case, Company A is considered to retain the elements of possession, command and control of its aircraft when it is used by Company B because Company A furnishes the pilots and provides the maintenance, insurance and fuel and pays the other operating expenses and overhead. Further, Company B will compensate Company A for the use of its aircraft through the reciprocal use of its aircraft.

  The IRS believes that Company's A and B are in the business of providing air transportation for compensation or hire. Under the interchange agreement, Company A will charge Company B an hourly rate based on one unit for the use of Company A's aircraft. Such use is essentially considered a barter exchange between Company A and Company B. As such, the IRS considers it to be a business arrangement between Company A and Company B to transport persons or property for hire.

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The IRS concluded that because Company A will receive compensation for the use of its aircraft and will retain possession, command and control of the aircraft, Company A is providing taxable air transportation within the meaning of Section 4261 of the Code. In answer to question 2, the tax should be computed on the basis of the fair market value of the unit of use described in the agreement. Note, there are two fair market values out there, yours and the IRS's, therefore it is recommended that you determine what the fair market value is for an hour of time on the aircraft and assess the commercial FET on that amount.

Disclaimer: This information is not intended to provide a complete analysis of this subject but is meant to provide the reader with an accurate synopsis of a complex issue.

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