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INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

Index (UIL) No.: 469.01-00
CASE MIS No.: TAM-108335-99

SEP - 1 1999
cc: DOM: P&SI: B

Chief, Appeals Office

Taxpayer's Name:
Taxpayer's Address:

TIN:
Years Involved:
Date of Conference:

LEGEND:

X =

A =

B =

Bank =

City =

State =

$m =

$n =

$o =

$r =

Y =

Date =

ISSUE: Are the services provided by X extraordinary personal services within the definition of § 1.469-1T(e)(3)(iii) of the temporary Income Tax Regulations so that the losses incurred by X are not from a rental activity?

CONCLUSION: The services provided by X are extraordinary personal services within the definition under § 1.469-

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1T(e)(3)(iii) of the regulations so that the losses incurred by X are not from a rental activity.

FACTS: In the early to mid-1990s, Bank, a publicly traded banking company, began a program of acquiring businesses that expanded Bank's business territory. During 1994 and 1995, Bank acquired the stock or the business of six financial corporations. By the end of 1995, Bank and its subsidiaries were operating in 29 states. As Bank expanded its territory it became necessary for Bank executives to frequently travel to manage its business and to complete due diligence work for acquisitions. Bank is headquartered in City in State. While City has a commercial airport, it is small and offers limited access to major airline services. Because of these conditions, Bank determined that it needed an alternative form of air transportation.

On Date, Bank's Board of Directors met to discuss the air transportation issue. Bank's Board of Directors minutes of Date indicate that Bank intended to purchase air transportation services and not use of the jet. The minutes further indicate that although Bank considered acquiring a jet in 1994, it decided that it would be inappropriate to expose itself to long-term liability when the period of sustained acquisition activity was unclear. Bank researched the services of commercial charter companies with specifications for a y jet and discovered that the lack of a charter company with a base in City meant that the cost of having continuous access to a suitable jet would be cost-prohibitive. Existing charter services were unwilling to move a pilot crew and jet on a permanent basis to a small market with a commitment in excess of that which Bank was willing to make. These services required notice, as long as 24 hours, in advance of any flight, in conflict with Bank's desire for immediate access to the jet. At the board meeting of Date, the Board approved a contract between Bank and X.

A, the CEO and minority shareholder of Bank, formed X in 1993 as an S corporation to provide transportation services. In that same year, X purchased a y jet for approximately $m. After acquiring the jet, X hired pilots and a maintenance staff.

X and Bank entered into jet use agreements beginning in 1994. The 1994 and 1995 agreements provide that X "shall provide services of the jet to Bank on a priority basis." The Bank's right to use the jet and the services of the employees of X are non-exclusive. The services provided by X include, but are not limited to, Bank's use of the jet provided by X, with crew, fuel, and food and refreshments. X bears all costs associated with the operation and maintenance of the jet, including, but not limited to, costs of fuel and other fluids, crew, landing fees, maintenance costs, and hangar space. The term of the agreements

was one year with the option to renew for two additional one-year periods. Bank is entitled to unlimited hours of flight and ground time each year during the agreement. As compensation, Bank paid X the aggregate annual amount of $r under the 1995 agreement. The agreements further provide that if the jet is totally destroyed, damaged beyond repair, or permanently rendered unfit or unavailable for use for any reason, the liability of Bank to pay compensation will be discharged.

X incurred losses of $n and $o for 1994 and 1995 respectively. X treated the losses as nonpassive losses and A deducted the losses on A's individual income tax returns.

LAW AND ANALYSIS: Section 469(a) disallows passive activity losses for the taxable year for individuals, estates, trusts, closely held C corporations, and personal service corporations. Section 469(c)(2) provides that the term passive activity includes any rental activity except as provided by § 469(c)(7) for certain rental real estate activities.

Section 469(j)(8) defines rental activity as any activity where payments are principally for the use of tangible property.

Section 1.469-1T(e)(1)(ii) of the temporary regulations provides that an activity is a passive activity of the taxpayer for a taxable year if and only if the activity is a rental activity (within the meaning of § 1.469-1T(e)(3)), without regard to whether or to what extent the taxpayer participates in such activity.

Section 1.469-1T(e)(3)(i) of the temporary regulations provides that, except as otherwise provided in § 1.469-1T(e)(3), an activity is a rental activity for a taxable year if (A) during such taxable year, tangible property held in connection with the activity is used by customers or held for use by customers; and (B) the gross income attributable to the conduct of the activity during such taxable year represents (or, in the case of any activity in which property is held for use by customers, the expected gross income from the conduct of the activity will represent) an amount paid or to be paid principally for the use of such tangible property (without regard to whether the use of the property by customers is pursuant to a lease or pursuant to a service contract or other arrangement that is not denominated a lease).

Section 1.469-1T(e)(3)(ii)(C) of the temporary regulations provides that an activity involving the use of tangible property is not a rental activity for a taxable year if for the taxable year extraordinary personal services (within the meaning of

§ 1.469-1T(e)(3)(v)) are provided by or on behalf of the owner of the property in connection with making such property available for use by customers (without regard to the average period of customer use).

Section 1.469-1T(e)(v) of the temporary regulations provides that for purposes of § 1.469-1T(e)(3)(ii)(C), extraordinary personal services are provided in connection with making property available for use by customers only if the services provided in connection with the use of the property are performed by individuals, and the use by customers of the property is incidental to their receipt of such services. For example, the use by patients of a hospital's boarding facilities generally is incidental to their receipt of the personal services provided by the hospital's medical and nursing staff. Similarly, the use by students of a boarding school's dormitories generally is incidental to their receipt of the personal services provided by the school's teaching staff.

Section 1.469-1T(e)(3)(viii) of the temporary regulations provides several examples to illustrate the operation of § 1.469-1T(e)(3). In Example (1) the taxpayer is engaged in an activity of leasing photocopying equipment. The average period of customer use for the equipment exceeds 30 days. Pursuant to the lease agreements, skilled technicians employed by the taxpayer maintain the equipment and service malfunctioning equipment for no additional charge. Service calls occur frequently (three times per week on average) and require substantial labor. The value of the maintenance and repair services (measured by the cost to the taxpayer of employees performing these services) exceeds 50 percent of the amount charged for the use of the equipment. Under these facts, services performed by individuals are provided in connection with the use of the photocopying equipment, but the customers' use of the photocopying equipment is not incidental to their receipt of the services. Therefore, extraordinary personal services (within the meaning of § 1.469-1T(e)(3)(v)) are not provided in connection with making the photocopying equipment available for use by customers, and the activity is a rental activity.

In Example (3) the taxpayer is engaged in an activity of transporting goods for customers. In conducting the activity, the taxpayer provides tractor-trailers to transport goods for customers pursuant to arrangements under which the tractor-trailers are selected by the taxpayer, may be replaced at the sole option of the taxpayer, and are operated and maintained by drivers and mechanics employed by the taxpayer. The average period of customer use for the tractor-trailers exceeds 30 days. Under these facts, the use of tractor-trailers by the taxpayer's customers is incidental to their receipt of personal services

provided by the taxpayer. Accordingly, the services performed in the activity are extraordinary personal services (within the meaning of § 1.469-1T(e)(3)(v)) and, under § 1.469-1T(e)(3)(ii)(C), the activity is not a rental activity.

In Frank v. Commissioner, T.C. Memo. 1996-177, petitioner leased an airplane to a lessee that subleased the airplane to customers who were learning to fly. Lessee paid petitioner for use of the airplane, held the airplane for use by customers, and paid for fuel, oil maintenance, inspection fees, insurance, and parts. Petitioner, with a mechanic, changed the airplane's oil, removed screws from the inspection plate, and tied down and washed the airplane. The Tax Court held that petitioner's losses from its airplane leasing activity are passive losses because services rendered to the lessee were not the dominant element of the relationship between the petitioner and lessee.

In this situation, X is engaged in the business of air transportation. While Bank's Board of Director minutes of Date indicate that one of the reasons it chose to contract with X was because X could provide a y jet, the dominant element of the contract is for X to provide for the transportation of Bank's personnel. X operates and maintains the jet and provides the pilots. As indicated in the Bank's minutes, Bank intended to contract for the transportation of its personnel. Therefore, we conclude that the losses incurred by X in 1994 and 1995 resulting from its transportation activity are not losses from a rental activity because the personal services provided by X are extraordinary personal services within the definition of § 1.469-1T(e)(3)(ii)(C) of the temporary regulations.

A copy of this technical advice memorandum is to be given to the taxpayers. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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