



# Federal Income Tax Treatment of Personal Use of Aircraft

**Keith G. Swirsky**

President, GKG Law, P.C.

[kswirsky@gkglaw.com](mailto:kswirsky@gkglaw.com)

Copyright © 2018 GKG Law, P.C.



# Personal Use of Aircraft

## Disclaimer

*This presentation is being provided for general information and should not be construed as legal advice or legal opinion on any specific facts or circumstances. You are urged to consult your attorney or other advisor concerning your own situation and for any specific legal question you may have.*

# Personal Use of Aircraft

- ▶ Federal Tax Planning Considerations
  - IRC Section 61 – Income inclusions for Individual
  - IRC Section 274 – Limitation of corporate deductions
- ▶ FAA Regulatory Considerations

# Personal Use of Aircraft

## IRC Section 61 – Income Inclusion for Individual

- ▶ IRC Section 61 provides rules governing the tax implications for employees (including family members and guests of employees) of utilizing an employer-provided aircraft for personal, non-business transportation.
- ▶ Business use is use in furtherance of the business of the employer.
- ▶ Non-business use is any other use, including predominantly:
  - Personal/recreational travel by the employee
  - Travel in furtherance of another business of the employee (e.g. another business that the employee or his/her family members own; brother-sister companies; affiliated entities)
  - Commuting

# Personal Use of Aircraft

## IRC Section 61 – Income Inclusion for Individual

- ▶ **IRS Rule:** Either employee must reimburse company for costs of non-business transportation, or company must impute fringe benefit income to employee for value of the transportation.
- ▶ **FAA General Rule:** Company cannot accept reimbursement from employee under Part 91.
- ▶ **Exceptions to FAA General Rule:**
  - Dry lease structure
  - Time sharing agreements
  - Nichols opinion

# Personal Use of Aircraft

## Exceptions to FAA General Rule: Dry Lease Structure

- ▶ Lease of aircraft without pilots.
- ▶ No limit on rent that may be charged.
- ▶ Lessee must contract for, and pay for, pilot services from a source independent of the Lessor.
- ▶ Lessee assumes operational control of aircraft and is responsible/potentially liable.
- ▶ Not subject to federal excise taxes on commercial transportation.
- ▶ Generally subject to state use taxes.

# Personal Use of Aircraft

## Exceptions to FAA General Rule: Time Sharing Agreements

- ▶ Far 91.501(c)(1): “An arrangement whereby a person leases his airplane with the flight crew to another person, and no charge is made for the flights conducted under that arrangement other than those specified in [FAR 91.501(d)].”
- ▶ Lessor typically retains operational control.
- ▶ Subject to federal excise taxes on commercial transportation.

# Personal Use of Aircraft

## Exceptions to FAA General Rule: Time Sharing Agreements

- ▶ FAR 91.501(d): Permits charges cannot exceed (but may be less than) 200% of the cost of fuel, oil, lubricants, and other additives used during the flight, plus 100% of out of pocket expenses for:
  - Travel expenses of the crew, including food, lodging and ground transportation
  - Hangar and tie down costs away from the aircraft's Operating Base
  - Insurance obtained for the specific flight
  - Landing fees, airport taxes and similar assessments
  - Customs, foreign permit, and similar fees directly related to the flight
  - In-flight food and beverages
  - Passenger ground transportation
  - Flight planning and weather contract services

# Personal Use of Aircraft

## Exceptions to FAA General Rule: Nichols Opinion

- ▶ FAR 91.501(b)(5) prohibits charges of any kind for transportation provided to guests of a company when not within the scope of and incidental to the business of the company.
- ▶ 1999, FAA Chief Counsel held in the “Schwab Opinion” that when an employee travels for personal purposes, the employee is a “guest” and the transportation is not within the scope of and incidental to the business of the company, and hence employee could not be charged for the flight.

# Personal Use of Aircraft

## Exceptions to FAA General Rule: Nichols Opinion

- ▶ In 2012, the FAA Chief Counsel’s “Nichols Opinion” modified the “Schwab Opinion” to permit charging a pro-rata share of the costs of owning, operating and maintaining the aircraft, for certain employees whose position with the company merits a high level of company interference into the employees’ personal travel plans (e.g., senior executive who may need to be recalled early from vacation).
- ▶ Company retains operational control.
- ▶ Subject to federal excise taxes on commercial transportation.
- ▶ Company must create and update a list of individuals whose position with the company require him or her to routinely change travel plans quickly.

# Personal Use of Aircraft

## IRC Section 61 – Income Inclusion for Individuals

- ▶ In order to comply with both the **IRS Rule** and the **FAA Rule**, the company's only options are:
  - To impute fringe benefit income to the employee for value of the transportation; or
  - To utilize one of the exceptions to the FAA general rule to permit the employee to reimburse the company.

# Personal Use of Aircraft

## IRC Section 61 – Income Inclusion for Individuals

- ▶ Two methods to determine value of the transportation for fringe benefit purposes:
  - Fair charter value method
  - Standard industry fare level (SIFL) method

# Personal Use of Aircraft

## Fair Charter Value

- ▶ Value of personal travel equal to the arm's-length cost to charter a similar aircraft for the flight.
- ▶ Allocate fair charter value of the flight among all employees on the aircraft unless some have the ability to control the use of the aircraft (e.g., senior execs) and others do not, in which case value is allocated among only those employees who have the ability to control the use of the aircraft.

# Personal Use of Aircraft

## SIFL Formula

- ▶ Simple mathematical formula that factors in:
  - Status of employee (control employee v. non-control employee).
  - Number of family members/guests accompanying employee.
  - Weight class of aircraft.
  - Distance flown (straight-line distance; statute miles).
- ▶ Applied separately to each employee on each flight leg (except ignore intermediate stops unrelated to personal purposes (e.g., fueling stops)).

# Personal Use of Aircraft

## SIFL Formula

- ▶ The SIFL formula also includes cents-per-mile rates and terminal charges that are adjusted and published semi-annually by the U.S. Department of Transportation.
- ▶ These “SIFL Rates”, are generally re-published by the IRS in revenue procedures shortly after publication by the Department of Transportation and are usually posted on the web site of the National Business Aviation Association ([www.nbaa.org](http://www.nbaa.org)).

# Personal Use of Aircraft

SIFL Rates 7/01/18 – 12/31/18

0-500 Miles: \$0.2346 per mile

501-1,500 Miles: \$0.1788 per mile

Over 1,500 Miles: \$0.1719 per mile

Terminal Charge: \$42.88

# Personal Use of Aircraft

## SIFL Formula Aircraft Multipliers

<b>Aircraft Max T.O. Weight</b>	<b>Control Employee</b>	<b>Non Control Employee</b>
Up to 6,000 lbs.	62.5%	15.6%
6,001 – 10,000	125%	23.4%
10,001 – 25,000	300%	31.3%
25,001 or greater	400%	31.3%

# Personal Use of Aircraft

## Defining the Flight to be Valued under SIFL

- ▶ The SIFL formula is applied on a flight by flight basis, with each takeoff and landing being treated as a single flight.
  - A round-trip flight is treated as two separate flights.
  - Similarly, a one-way trip with a stopover at an intermediate destination is treated as two separate flights, unless the intermediate stop is made for any reason unrelated to the personal purposes of the employee whose flight is being valued.

# Personal Use of Aircraft

## Defining the Flight to be Valued under SIFL

- ▶ Where a flight is provided to an employee to a particular destination for a combination of personal and business purposes, income is imputed only if the personal purpose of the flight is primary.
- ▶ The determination of whether a flight is a primarily for personal or business purposes is based on a facts and circumstances analysis.

# Personal Use of Aircraft

## Special Rules: Mixed Business and Personal Trips

- ▶ Single destination for both business and personal purposes: primary purpose controls.
- ▶ Single trip with separate business and personal destinations: determine primary purpose of trip as a whole:
  - Trip primarily business: SIFL miles = actual miles flown in excess of miles of hypothetical trip that includes only business destinations.
  - Trip primarily personal: SIFL miles = miles of hypothetical trip that includes only personal destinations.
- ▶ Primary purpose analysis based on facts and circumstances.

# Personal Use of Aircraft

## Special Rules: Seating Capacity Rule

If individuals traveling for the employer's business occupy at least 50% of the regular passenger seating capacity of the aircraft, then:

- ▶ The SIFL value of travel by employees, spouses and dependents is \$0.
- ▶ The SIFL value of travel by non-employees is at the non-control employee rates.

# Personal Use of Aircraft

## IRC Section 61 – Income Inclusion for Individual

- ▶ Note: if employer utilizes one of the exceptions to the FAA general rule to permit the employee to reimburse the company, and if the reimbursement amount is less than the amount that would otherwise have been imputed under the fringe benefit rules, then the employer may nevertheless have to impute fringe benefit income for the excess of fringe benefit valuation over the reimbursed amount.
- ▶ The foregoing is most likely to occur in situations where all, or nearly all, of the seats on the aircraft are occupied by family members or guests of an employee.

# Personal Use of Aircraft

## IRC Section 274 – Limitation of Corporate Deductions

- ▶ Section 274 of the tax code limits deductions for expenses of ***facilities*** used for entertainment, amusement or recreational purposes.
- ▶ A business aircraft is considered to be such a facility; the law applies to such use of an aircraft by “Specified Individuals.”
- ▶ Requires that expenses and depreciation be allocated to business travel and entertainment/commuting travel on a pro rata basis, and denies or limits deductions for expenses and depreciation allocated to entertainment/commuting.
  - Consider effects of entertainment/commuting use on bonus depreciation in the year the aircraft is placed in service.

# Personal Use of Aircraft

## Who is a Specified Individual?

- ▶ The term “Specified Individuals” includes all officers, directors and persons directly or indirectly owning more than 10% of any equity class of the taxpayer, or any related party (within the meaning of IRC §§ 267(b) or 707(b)).
  - Applies to private companies, publicly-held companies, partnerships, and tax-exempt entities.
  - Includes spouse, family members or guests of the Specified Individual.

# Personal Use of Aircraft

## What is Entertainment?

- ▶ Sports Events
- ▶ Hunting
- ▶ Fishing
- ▶ Golfing
- ▶ Travel to Country Clubs
- ▶ Skiing
- ▶ Resort Destinations



# Personal Use of Aircraft

## What Activities are Personal, but do not Constitute Entertainment?

- ▶ Commuting\*
- ▶ Travel to a funeral
- ▶ Travel for medical purposes
- ▶ Travel for charity work
- ▶ Travel for business other than that of the employer providing the flight
- ▶ Travel to meeting with personal advisors
- ▶ Transportation between homes not associated with entertainment



# \*2017 Tax Cuts and Jobs Act

## New Restriction on Deductibility of Commuting Expenses

- ▶ TCJA provides that “no deduction that be allowed . . . for any expense incurred for providing any transportation, or any payment or reimbursement, to an employee of a taxpayer in connection with travel between the employee’s residence and place of employment, except as necessary to ensure the safety of the employee.”
- ▶ Previously, such expenses were deductible to the company as personal, non-entertainment travel if income was imputed to the employee (i.e., SIFL).
- ▶ Going forward, while commuting is not, strictly speaking, considered “entertainment”, it is now treated similarly.

# Personal Use of Aircraft

## Travel for Both Business & Recreational Purposes Single Destination

- ▶ The final regulations do not address how to determine whether a Specified Individual's trip to a particular destination should be categorized as business or entertainment when both activities are conducted.
- ▶ Other regulations governing the imputation of fringe benefits provide that income must be imputed to an employee only if the personal purpose of the employee in traveling to a particular destination is primary.
- ▶ In light of the absence of guidance, it should be reasonable to assume that a similar methodology may be used.

# Personal Use of Aircraft

## Travel for Both Business & Recreational Purposes Multiple Destinations

- ▶ When a flight provided to a Specified Individual includes one or more destinations for business purposes, and one or more other destinations for entertainment purposes, the flight hours/miles allocated to entertainment use will be the excess of the total flight hours/miles flown during the trip over the number of flight hours/miles that would have been flown if the flights to the entertainment destinations had not occurred.

# Personal Use of Aircraft

## What Expenses are Subject to Disallowance?

- ▶ Taxpayers must include all expenses of operating and maintaining the aircraft during the taxable year, including, for example:
  - Fuel
  - Landing fee
  - Overnight hangar fees
  - Catering
  - Meal and lodging expenses of the flight crew
  - Management fees
  - Hangar rent
  - Salaries of pilots
  - Maintenance personnel and other personnel assigned to the aircraft maintenance costs
  - Lease payments (if aircraft is leased rather than owned)
  - Charter fees (if aircraft is chartered rather than owned)

# Personal Use of Aircraft

## What Expenses are Subject to Disallowance

- ▶ While not normally considered an “expense” from a financial accounting point of view, taxpayers must also include tax depreciation when calculating expenses.
- ▶ Interest “properly allocable” to an aircraft, under the interest tracing rules, is an expense subject to disallowance.
  - Under the interest tracing rules, interest does not have to be incurred in connection with an aircraft specific financing, but rather may include general borrowing, for example, pursuant to a corporate line of credit, when a portion of the line of credit interest is utilized for the purchase of the aircraft.

# Personal Use of Aircraft

## Special Rules Regarding Depreciation Expense

- ▶ Taxpayers may elect to calculate depreciation using the ADS straight-line method over the class life of the aircraft solely for purposes of calculating the amount of the disallowed expense, even if another method is used for tax or book purposes.
- ▶ The election may be made for aircraft placed in service in prior years. In such cases, apply straight-line to original basis as if the election had been in effect since the aircraft was placed in service.
- ▶ If taxpayer elects to use the straight-line method for one aircraft, it must use the method for all aircraft it owns.

# Personal Use of Aircraft

## Methodologies for Calculating Disallowance of Aircraft Expense Deductions

- ▶ Calculate disallowance using all available methods, and use method that provides the best result.
  - Passenger by passenger method by seat hours
  - Passenger by passenger method by seat miles
  - Flight by flight method by seat hours
  - Flight by flight method by seat miles

# Personal Use of Aircraft

## Record Keeping and Calculations under Passenger Seat Hour/Seat Mile Methods

- ▶ The taxpayer must maintain records of all aircraft expenses, and either the total number of flight hours or miles flown by each individual passenger on each flight of the aircraft, and then must categorize the hours or miles flown by each individual on each flight in one of 3 buckets: business non-entertainment, entertainment/commuting or personal non-entertainment.



# Personal Use of Aircraft

## Record Keeping and Calculations under Passenger Seat Hour/Seat Mile Methods

Assume 5 passengers on board (all Specified Individuals), 3 of whom are traveling on business non-entertainment, 1 is traveling for entertainment/commuting, and 1 is traveling for personal non-entertainment. The trip is 1,000 miles, and the seat miles methodology is used:

	<u>Passengers</u>	<u>Miles</u>	<u>Total Seat Miles</u>
<b>Business Non-Entertainment</b>	3	1,000	3,000
<b>Entertainment/Commuting</b>	1	1,000	1,000
<b>Personal Non-Entertainment</b>	1	1,000	1,000

# Personal Use of Aircraft

## Record Keeping and Calculations under Passenger Seat Hour/Seat Mile Methods

- ▶ At the end of the tax year, all occupied seat miles (or hours) in all three buckets are totaled.
- ▶ The sum of all expenses subject to disallowance is divided by the total sum of occupied seat miles (or hours) in all 3 buckets.
- ▶ The average cost per occupied seat mile (or hour) for the taxable year is determined.

# Personal Use of Aircraft

## Allocating Expenses to Business and Entertainment Uses under Passenger Seat Hour/Seat Mile Methods



- ▶ The average cost per occupied seat mile (or hour) is multiplied by the total number of occupied seat miles (or hours) for a given entertainment flight to determine the expenses associated with the entertainment flight.

# Personal Use of Aircraft



## Allocating Expenses to Business and Entertainment Uses under Passenger Seat Hour/Seat Mile Methods

- ▶ The total amount imputed as income to, or reimbursed by, the Specified Individual for each individual entertainment flight (not to exceed the entertainment expenses associated with the flight) is subtracted from the entertainment expenses associated with the flight to determine the amount disallowed.

# Personal Use of Aircraft

## Record Keeping

- ▶ At Audit, IRS may assume **ALL** aircraft use is personal **AND** entertainment, **unless taxpayer proves otherwise.**

# Personal Use of Aircraft

## Record Keeping

- ▶ The taxpayer must maintain records of:
  - All aircraft expenses.
  - The departure airport, destination airport, and total number of flight hours and statute miles flown during each flight leg flown.
  - For each individual passenger on each flight leg: the passenger's name, departure airport, destination airport, and purpose for traveling to the destination.
  - For each employee passenger on each flight leg: the status of such employee as a "Control Employee" and/or a "Specified Individual", if applicable (these terms will be defined after the break).
  - For each non-employee passenger: the name of the employee who is responsible for the non-employee.
- ▶ Records establishing the purpose of an individual's travel should be created contemporaneously with the flight.
  - Records created after the fact (i.e., once an audit has been commenced) will be less persuasive.

# Personal Use of Aircraft

## Record Keeping

- ▶ An employee should be assigned to collect and organize all of the above data into a useful format on an on-going basis.
  - The employee assigned to collect and organize the data should be someone who has a reasonable understanding of the applicable rules, regulations and definitions, and who is comfortable questioning senior executives and their guests concerning the nature of their travel.



**Keith Swirsky**  
**President, GKG Law, P.C.**

1055 Thomas Jefferson St. NW  
Suite 500

Washington, D.C. 20007

Tel: (202) 342-5251

Cell: (703) 597-5123

[kswirsky@gkglaw.com](mailto:kswirsky@gkglaw.com)

Copyright © GKG Law, P.C.