

Aviation Tax Law Webinar

Federal Income Tax Treatment of Personal Use of Aircraft



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Personal Use of Corporate Aircraft

- Part 1: Tax Consequences for the Individual
- Part 2: Tax Consequences for the Company



Personal Use of Corporate Aircraft

→ Part 1: Tax Consequences for the Individual



Personal Use of Corporate Aircraft

- When employee uses company aircraft for personal, non-business transportation --
- **IRS Rule:** either
 - employee must reimburse company for costs of the transportation, or
 - Company must impute fringe benefit income to employee for value of the transportation
 - **FAA Rule:** company cannot accept reimbursement from employee under Part 91



Personal Use of Corporate Aircraft

→ In order to comply with both the **IRS Rule** and the **FAA Rule**, the company's only option is to impute fringe benefit income to the employee for value of the transportation



Personal Use of Corporate Aircraft

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

- Consistency requirement



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



SIFL Formula

- Simple mathematical formula that factors in:
 - Status of employee (control employee vs. 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))



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)



SIFL Rates 01/01/13 – 06/30/13

0-500 Miles: \$0.2655 per mile

501-1,500 Miles: \$0.2024 per mile

Over 1,500 Miles: \$0.1946 per mile

Terminal Charge: \$48.54



SIFL Formula Aircraft Multipliers

Aircraft Max T.O. Weight	Control Employee	Non Control Employee
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%



The SIFL Formula

Step 1: Multiply statute miles flown by appropriate per-mile rate(s)

Step 2: Add Terminal Charge

Step 3: Multiply by Appropriate Aircraft Multiplier

Step 4: Multiply by # of Passengers



SIFL Formula

→ "Control Employees" include

- Board or shareholder appointed, confirmed or elected officers, limited to the lesser of (1) one percent of all employees or (2) ten employees
- Among the top one percent of highly compensated employees, limited to a maximum of 50
- Owners of five percent or greater equity, capital or profits interest of the company
- Directors of the company



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



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 a business purposes, income is imputed only if the personal purpose of the flight is primary
- ➔ The determination of whether a flight is primarily for personal or business purposes is based on a facts and circumstances analysis



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



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



Special Rules: Working Condition Fringe

If employer requires control employee to travel on corporate aircraft for personal travel, Aircraft Multiplier will be limited to 2.0, regardless of aircraft weight class, if:

- Bona-fide security concern
- Part of over-all security program
- Recommended by independent security study



Personal Use of Corporate Aircraft

→ Part 2: Tax Consequences for the Company



American Jobs Creation Act of 2004

- Section 274 of the tax code limits deductions for expenses of facilities (including aircraft) used for entertainment, amusement or recreational purposes
- A business aircraft is considered to be such a facility
- The American Jobs Creation Act of 2004 (the “Act”) amended Section 274 to overrule the Sutherland Lumber decision for aircraft expenses incurred after October 22, 2004



American Jobs Creation Act of 2004

- Old Law: Expenses for employees' personal, non-business flights were fully deductible under Sutherland Lumber if income was imputed to the employee for the value of the flight (e.g., *SIFL*)
- New Law: Expenses for entertainment, amusement, and recreational flights of "Specified Individuals" are now deductible only UP TO the amount of income imputed to (or reimbursement received from) the Specified Individuals



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



American Jobs Creation Act of 2004

- ➔ New law does not alter deductibility of expenses attributable to travel of Specified Individuals for business purposes, or for personal flights for other than entertainment, recreational, amusement purposes
- ➔ New Law does not alter deductibility of expenses attributable to travel of Non-Specified Individuals for any purposes, including entertainment, recreational, amusement purposes



American Jobs Creation Act of 2004

- The IRS issued Notice 2005-45 in 2005, followed by proposed regulations in 2007, to answer many open questions
- Notice 2005-45 provided interim guidance for calculating the disallowance based on passenger seat miles/hours method
- The Proposed Regulations add the “flight by flight” method



American Jobs Creation Act of 2004

- The IRS published final regulations Aug. 1 2012, superseding Notice 2005-45 and the proposed regulations for all flights on and after such date
- The final regulations largely adopt the rules contained in Notice 2005-45 and the proposed regulations



What is Entertainment?

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



What Activities are Personal, but do not Constitute Entertainment?

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



Travel for Both Business and 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 in the Notice and the Proposed Regulations, it should be reasonable to assume that a similar methodology may be used



Travel for Both Business and 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



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 fees
 - 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)



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
- Final regulations also provide that 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 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
- Interest was not mentioned or specifically listed as an includable expense in Notice 2005-45 or the proposed regulations



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



Special Rules Regarding Depreciation Expense

- Final Regulations also clarify that where a taxpayer elects to use ADS for purposes of calculating the disallowance attributable to entertainment flights, the amount disallowed is any given year as a result of the election to utilize ADS may not exceed the amount of depreciation otherwise allowable for that tax year
- This may result in less than 100% of the basis in the aircraft being subject to disallowance over time



Special Rules Regarding Depreciation Expense

Example of \$1m basis in aircraft depreciable under MACRS over 5 years or ADS over six (half-year convention), where Aircraft is used 50% of the time for Entertainment purposes:

	Normal	274	Normal	274
	MACRS	Disallowed Portion	ADS	Disallowed Portion
Year	Deduction	of Deduction	Deduction	of Deduction
1	200,000	100,000	83,333	41,667
2	320,000	160,000	166,667	83,334
3	192,000	96,000	166,667	83,334
4	115,200	57,600	166,667	83,334
5	115,200	57,600	166,667	83,334
6	57,600	28,800	166,667	57,600
7	0	0	83,333	0
Total:	1,000,000	500,000	1,000,001	432,601



Special Rules Regarding Depreciation Expense

- ➔ Election may only be revoked for compelling reasons with IRS consent
- ➔ The expense disallowance provisions are applied on a pro-rata basis to all of the disallowed expenses
- ➔ Tax basis is only reduced by the amount of depreciation actually allowed after application of the disallowance rules
- ➔ Disallowed depreciation is suspended basis, which will be treated as basis in an asset which is used for personal, living and family purposes, in accordance with IRS Reg. 1.274-7



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



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 or personal non-entertainment

Business Non-Entertainment



Entertainment



Personal Non-Entertainment



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, 1 is traveling for personal entertainment, 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>
Business	3	1,000	3,000
Personal Entertainment	1	1,000	1,000
Personal Non-Entertainment	1	1,000	1,000



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



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



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



Closing Remarks



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