Board of Directors Briefing
Charge-Backs for Personal Use

By
Keith G. Swirsky, Esq.
Troy A. Rolf, Esq.
GKG Law, P.C.

Allowing executives use of the company aircraft for personal travel raises many issues that attorneys Keith Swirsky and Troy Rolf examine in this brief for Board Members. A decision by a corporation's Board of Directors to allow executives the use of the company's aircraft for personal travel gives rise to a variety of sensitive issues, such as whether the executive should be required to compensate the corporation for the use of the aircraft, and if so, how much? Or, conversely, should the use of the aircraft for personal purposes be treated as additional compensation to an executive? There are a variety of tax regulatory issues that a Board must consider in answering these questions. In a previous Board of Directors Briefing, we discussed various tax issues associated with treating personal use of corporate aircraft as compensation to an executive. In this article, we discuss the Federal Aviation Regulations ("FAR") governing when and how the executive may be charged for the use of the aircraft.

US aircraft owned or leased as an industrial aid and flown not for hire are regulated by FAR Part 91. As stated in FAR 91.501(b)(5), a corporation operating a business jet for its private use may only charge for travel on the aircraft when the compensation for travel is "within the scope of and incidental to" the corporation's business. In a 1993 letter commonly referred to as the "Schwab Opinion", the FAA Chief Counsel interpreted this rule to prohibit corporations from charging executives for any of the costs associated with the use of the corporation's aircraft for the executive's own personal, non-business purposes. However, the FAA Chief Counsel has recently liberalized its interpretation. Under the revised interpretation, a corporation may charge executives for certain costs incurred in providing routine personal travel, where the executive's position with the corporation merits a high level of corporate interference into the executive's personal travel plans (e.g., senior executive who may need to be recalled early from vacation).

The maximum amount that may be charged under the revised interpretation is an amount that does not exceed a pro-rata share of the costs of owning, operating and maintaining the aircraft. Neither FAR 91.501(b)(5) nor the FAA Chief Counsel provides a list of what costs are included in "the costs of owning, operating and maintaining the aircraft." Corporations therefore have some degree of flexibility in determining what constitutes a pro-rata share of the costs of owning, operating and maintaining their aircraft. However,

Copyright GKG Law, P.C. 2011

amounts charged under the revised interpretation probably should include only cash items constituting fixed, variable and direct operating expenses (e.g., fuel, pilot salaries, maintenance costs, insurance premiums, mortgage interest expense, hangar rent, etc.) and a reasonable allocation of "economic" depreciation.

The revised FAA Chief Counsel guidance indicates that corporations cannot charge all personal travel by executives. Rather, only those personal flights that could readily be altered or cancelled for compelling business reasons would qualify. For example, if it is possible that a high-level employee could be recalled early from a trip(such as a vacation) for business reasons, the use of the corporate aircraft by such high-level employee could qualify. On the other hand, where personal travel plans are unlikely to be altered or cancelled, *even for compelling business reasons*, such flights would not qualify. For example, according to the FAA Chief Counsel: "absent an emergency, it may be unlikely that a high-level employee would be expected to miss a significant event, such as a wedding or a funeral of a close family member. It is also unlikely that an employee would be expected to cancel or reschedule necessary or urgent medical treatment."

In order to take advantage of the liberalized reimbursement rules, a corporation's Board of Directors would need to determine which high-level executives hold positions that would subject them to being recalled from vacations and other personal trips on very short notice to meet the needs of the corporation, and would need to maintain lists of those high-level executives who meet such criteria. Further, determinations would need to be made on a flight-by-flight basis as to whether a flight by a high-level executive meets the requirements for charging.

Of course, not all personal travel will be eligible for charging under the revised FAA Chief Counsel interpretation. Fortunately, where a Board of Directors determines it is appropriate to charge executives for personal use of the corporation's aircraft, other alternatives exist to avoid the prohibition in FAR 91.501(b)(5) and accomplish the Board's objective. For example, the corporation could "Dry Lease" the aircraft to the executive. (A "Dry Lease" is a lease without a flight crew, meaning that the executive would need to obtain pilots from a source independent of the corporation.) If the aircraft is managed and crewed by an independent aircraft management company, rather than by in an in-house flight department, the executive could contract with the aircraft management company to use the same crew that the corporation uses, but the corporation could not require the executive to do so. Under a Dry Lease, there are no limits on the amount that the corporation may charge the executive as "rent." A draw back of a Dry Lease is that the executive becomes personally responsible (and potentially liable) for the operation of the aircraft, without benefit of a corporate shield.

Another option is for the corporation and the executive to enter into a "Time Share Agreement," which essentially is a "Wet Lease" (i.e., a lease of an aircraft with a flight crew). Use of a Time Share Agreement avoids making the executive accept personal responsibility and liability for the operation of the aircraft, but the trade-off is that the amount that may be charged for use of the aircraft is strictly limited to two-times the cost of the fuel used for a given flight, plus reimbursement of a few itemized out-of-pocket

Copyright GKG Law, P.C. 2011

expenses specified in FAR 91.501(d) (e.g., landing fees and overnight expenses of the flight crew). In addition, charges under Time Share Agreements are generally subject to Federal Excise Taxes ("FET") on air transportation, which would not be the case under a Dry Lease. FET is currently charged in an amount equal to 7.5% for domestic transportation (plus a de minimis segment fee charged on a per person, per segment basis) (FET for international flights is significantly less).

Finally, if the aircraft is managed by an independent aircraft management company that possesses an FAA Air Carrier Certificate, the executive can simply "charter" the aircraft from the management company for personal flights. Doing so helps to eliminate both the personal responsibility and liability of the executive for the operation of the aircraft associated with Dry Leases, as well as the limits on compensation associated with Time Share Agreements. But chartering has its own drawbacks. Specifically, the aircraft would need to be operated under FAR Part 135, which is a higher level of regulation that can be both more expensive and less flexible than operations under Part 91. Chartering also subjects flights to the same FET issues as Time Share Agreements.

* * *

This briefing provides only an introduction to the issues associated with charging executives for personal use of corporate aircraft corporate aircraft. The rules are quite complex, and boards of directors should consult experienced aviation tax/regulatory counsel before establishing any corporate policy concerning personal use of corporate aircraft by executives.

Keith G. Swirsky is President of GKG Law and is a tax specialist concentrating in the areas of business aircraft transactions and aviation taxation. Mr. Swirsky may be reached at the firm's Washington, D.C. office, 1054 31st Street, NW, Suite 200, Washington, D.C. 20007, Telephone: (202)342-5251, Facsimile: (202)965-5725, E-mail: kswirsky@gkglaw.com.

Troy A. Rolf is a business aviation and tax attorney concentrating in the areas of business aircraft transactions and operations in the law firm of GKG Law, P.C., and manages the firm's Minnesota office. Troy can be contacted at 700 Twelve Oaks Center Drive, Suite 700, Wayzata, MN, 55391, telephone: (952) 449-8817, facsimile (952) 449-0614, e-mail: trolf@gkglaw.com.

Copyright GKG Law, P.C. 2011