Board Of Directors Briefing:

Tax implications of using the company aircraft for personal and recreational purposes.

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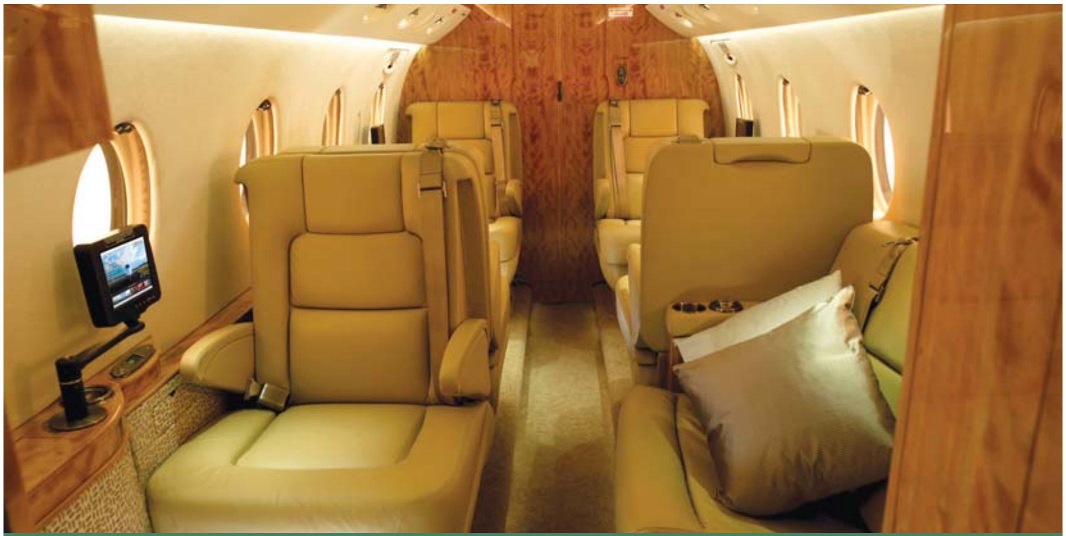
Expenses that are ordinary, necessary and reasonable for the conduct of business are deductible as appropriate costs, but those three conditions have proscribed limits, cautions Attorney Troy Rolf.

Expenses associated with Business Aviation are generally deductible for federal income tax purposes provided the aircraft are used in an active trade or business, and the expenses are ordinary, necessary and reasonable. An expense is considered to be ordinary, necessary and reasonable if:

- The expense is "appropriate" and "helpful" in carrying on the taxpayer's trade or business;
- The expenditure is a common and accepted practice in the taxpayer's trade or business; and
- The expense is reasonable in amount.

Existing court precedents recognize that use of a corporate aircraft for executive transportation is a common and accepted practice in many industries. However, when those same executives also use their corporate aircraft for personal or recreational travel, the tax rules get murky.

Expenses incurred by an executive for personal, non-business transportation are generally not deductible. However, expenses incurred by corporations and other business entities to compensate executives for services rendered are generally deductible as long as such expenses meet the ordinary, necessary and reasonable standard. Consequently, when an executive's compensation package includes use of his or her employer's corporate jet for non-business travel, the expenses incurred by the employer arguably may be considered compensation expenses. ›



TAX RULES BECOME MURKY WHEN JET USE MIXES BUSINESS AND PLEASURE

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In order for the employer to deduct expenses associated with an executive's non-business travel, however, IRS regulations require that the executive either reimburse the employer for the fair value of using the aircraft or that the employer impute to the executive the fringe benefit income in an amount equal to the value of the transportation. Such imputed income is a liability on the executive's personal tax return.

Federal tax law and FAA regulations are not fully coordinated, however. FAA regulations typically prohibit executives from reimbursing their employers for the use of the aircraft for non-business travel unless the aircraft is operated under Part 135 of the FARs or pursuant to a time-sharing agreement. Consequently, most corporations impute the value of non-business travel to their executives as fringe benefit income.

CALCULATING THE COST

IRS Regulations provide employers a choice of two methods for determining the value of using an employer's aircraft for fringe benefit taxation purposes. The first method, known as the fair charter value method, requires that income be imputed in an amount equal to the cost that would have been incurred to charter a similar flight from a third-party commercial charter operator.

The second method, commonly known as the standard industry fare level (SIFL) method, relies on a fixed mathematical formula that includes factors related to a flight, such as the distance flown, the weight class of the aircraft, the status of the executive as a "Control Employee" or a "Non-Control Employee," and the number of family members and guests who accompany the executive on the flight.

Of these two methods, the SIFL method is far and away the most popular for several reasons. The SIFL formula usually (but not always) results in a smaller amount of income being imputed to the executive than the fair charter value method. Furthermore, the administrative burden of calculating values under the SIFL method is far less than determining the fair charter value of the flight.

ENTERTAINMENT, AMUSEMENT OR RECREATIONAL

Unfortunately, imputing income to an executive for a personal flight does not always result in the expenses associated with operating the flight being deductible by the employer. Under the Internal Revenue Code, even when the values of personal flights have been properly imputed to executives, the employer's ability to deduct the expenses, as well as the tax depreciation attributable to the flight, will be limited when:

- The flight was for an 'Entertainment', 'Amusement' or 'Recreational' purpose, and
- The executive is a 'Specified Individual'.

The terms 'Entertainment', 'Amusement' and 'Recreation' mean any activity of a type generally considered to constitute entertainment, amusement or recreation. The term 'Specified Individuals' means any person who is the direct or indirect owner of more than 10% of any class of equity or security of the taxpayer, and any officer or director of the taxpayer.

For such flights, the employer's expense and tax depreciation deductions attributable to the flight will be limited to an amount equal to the amount that was imputed to the executive as income for the flight, even though the operating and depreciation costs of the aircraft for the hours flown might be higher.

The IRS has established alternative passenger-by-passenger, and flight-by-flight methods for calculating the amount of expenses and tax depreciation to be allocated to business travel vs. Entertainment, Amusement and Recreational travel. While an explanation of the nuts and bolts of each of the various methods is beyond the scope of this presentation, for purposes of this article it will suffice to say that the rules are byzantine in nature.

This article provides only a very brief introduction to the topic of federal taxation of personal and recreational use of corporate aircraft by executives. The tax rules governing personal use are very complex, and Boards of Directors should consult experienced aviation tax counsel before establishing any corporate policy concerning personal use of corporate aircraft by executives.

Do you have any questions or opinions on the above topic? Get them answered/published in World Aircraft Sales Magazine. Email feedback to: Jack@avbuyer.com