

**GKG Law, P.C. Presents  
An Aviation Tax Law Webinar  
June 17, 2009**

**Planning to Minimize the Impact of the Rules  
on Personal Use of Business Aircraft**



# Overview

Old Law: Sutherland Lumber

New Law: American Jobs Creation Act of 2004

Notice 2005-45

Proposed Regulations

Final Regulations?



# Overview

## Sutherland Lumber

Permitted companies to deduct all expenses and depreciation of personal and recreational flights of shareholders and employees, so long as fringe benefit income was imputed to the shareholders and employees for the value of the flights



# Overview

## American Jobs Creation Act of 2004

Overrules Sutherland Lumber to disallow operating expense and depreciation deductions arising from “**Recreational**” use of aircraft by “**Specified Individuals**”



# Overview

Notice 2005-45: Provides interim guidance for implementation of Jobs Act (includes mathematical formula for calculating disallowance)

Proposed Regulations: Incorporates mathematical formula from Notice 2005-45, but also permits alternate “flight-by-flight” methodology

Final Regulations: ???



# Overview

- New law does not alter deductibility of expenses attributable to travel of **Specified Individuals** for business purposes, or for personal non-recreational purposes
- New Law does not alter deductibility of expenses attributable to travel of **Non-Specified Individuals** for any purposes, including recreational purposes



# Who is a Specified Individual?

The term “**Specified Individual**” 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))

→ Includes spouse, family members or guests of the specified individual



# What is Recreation?

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





# Strategies for Avoiding/Minimizing Disallowance of Aircraft Expense Deductions

- Carefully analyze the purpose of all “Personal” flights taken by each Specified Individual
- Not all “Personal” flights need to, or should, be characterized as “Recreational”
- NOTE: The purpose of all business flights, and all “Personal” flights that are *NOT* “Recreational”, must be documented



# What Activities are Personal, but may not Constitute Recreation?

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



# What Expenses are Subject to Disallowance?

**Notice 2005-45:** Taxpayers must include **tax depreciation**, as well as all expenses of operating and maintaining the aircraft during the taxable year, including, for example:

- fuel
- landing fees
- catering
- meal and lodging expenses of the flight crew
- management fees
- hangar rent
- salaries of pilots
- insurance
- 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 Might NOT be Subject to Disallowance?

Open Issue:

→ Interest expense



# Methodologies for Calculating Disallowance of Aircraft Expense Deductions

Calculate disallowance using all available methods, and use method that provides the best result

- Notice 2005-45 method by seat hours
- Notice 2005-45 method by seat miles
- Flight by flight method by seat hours
- Flight by flight method by seat miles



# Record Keeping and Calculations under Notice 2005-45

## 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, personal entertainment or personal non-entertainment

**Business**



**Personal  
Entertainment**



**Personal Non-  
Entertainment**



# Record Keeping and Calculations under Notice 2005-45

## Seat Hour/ Seat Mile Methods

Assume 5 passengers on board (all Specified Individuals), of which 3 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 Notice 2005-45

## 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 Notice 2005-45 Seat Hour/ Seat Mile Methods

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



# Allocating Expenses to Business and Entertainment Uses under Notice 2005-45 Seat Hour/ Seat Mile Methods

The total amount imputed as income to, or reimbursed by, the Specified Individual for the 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



# Allocating Expenses to Business and Entertainment Uses under the Proposed Regulations Flight by Flight Methodology

- Determine total costs for the year
- Determine total flight hours/miles for the year
- Calculate costs per flight hour/mile
- Review all flight legs that have passengers travelling for entertainment purposes
- Multiply hour/mile cost times hours/miles of flight to determine cost of the flight
- Prorate costs of flight on a per passenger basis, and net against SIFL income for such passengers



# Strategies for Avoiding/Minimizing Disallowance of Aircraft Expense Deductions

- Increase the number of individuals traveling for business purposes to increase the proportion of business hours/miles by bringing additional members of your team to business meetings when feasible
- Decrease the number of individuals traveling for recreational purposes in order to minimize the overall proportion of recreational hours/miles



## Strategies for Avoiding/Minimizing Disallowance of Aircraft Expense Deductions

- Under the Proposed Regulations, expenses allocable to leases or charters to unrelated third-parties in bona-fide transactions for full and adequate consideration may be excluded
- Caution: Adverse Passive Loss (IRC 469) impact could outweigh benefits – consult your tax advisor



# Arm's Length Charters/Leases

## Charter/Dry Lease to Specified Individuals:

- The **Proposed Regulations** do not address expenses allocable to leases or charters of the employer's aircraft to Specified Individuals at arm's length rates. The IRS has stated, however, that the exception in the preceding slide does not apply to such transactions



# Strategies for Avoiding/Minimizing Disallowance of Aircraft Expense Deductions

- Plan ahead to combine business trips with entertainment trips
  - Business and entertainment at a single destination
  - Business and entertainment at separate destinations



# Travel for Both Business and Recreational Purposes

## \*\*\*Single Destination\*\*\*

- Notice 2005-45 does not address how to determine whether a Specified Individual's trip to a particular destination should be categorized as business or recreational, when both activities are conducted
- Existing 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



# Strategies for Avoiding/Minimizing Disallowance of Aircraft Expense Deductions

- Plan ahead to minimize deadheading related to Entertainment flights
- The allocation of passengers and expenses to a deadhead flight occurring between two occupied flights is based on the number of passengers on board for the two occupied legs



# Strategies for Avoiding/Minimizing Disallowance of Aircraft Expense Deductions

## \*\*\*Multiple Aircraft Available\*\*\*

If more than one private aircraft is available for use, the following three-part strategy may help reduce your disallowance:

1. Use newer, higher-basis aircraft solely for business and personal non-entertainment flights
2. Calculate disallowance for each aircraft separately (i.e., do not aggregate)



# Strategies for Avoiding/Minimizing Disallowance of Aircraft Expense Deductions

## \*\*\*Multiple Aircraft Available\*\*\*

3. Use less expensive alternatives for all recreational flights, such as

- Older, lower basis aircraft in fleet
- Jet Cards
- Charter
- Time Share of Third Party Aircraft
- Dry Lease
- Interchange



# Possible Future Charter Rate Safe Harbor

- **Proposed Regulations:** no charter rate safe harbor currently exists; however, the proposed regulations indicate that such a safe harbor is under consideration and the IRS has invited comments on the concept
- A charter rate safe harbor could be very advantageous for high basis aircraft





**Keith G. Swirsky**  
**GKG Law, P.C.**  
**1054 31<sup>st</sup> St., Suite 200**  
**Washington, D.C. 20007**  
**Tel: (202) 342-5251**  
**Fax: (202) 965-5725**  
**kswirsky@gkglaw.com**  
**[www.aviationtaxlawyer.com](http://www.aviationtaxlawyer.com)**

