PRIVATE AVIATION SECURITY PROGRAMS: REQUIRING EMPLOYEES TO USE EMPLOYER-PROVIDED AIRCRAFT FOR PERSONAL FLIGHTS CAN HAVE INCOME TAX CONSEQUENCES

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In the aftermath of the September 11th terrorist attacks on the United States, concern in the nation's workplaces for the safety of employees has reached new levels. Perhaps nowhere has this concern been focused to a greater degree than on issues surrounding the safety and security of the world's commercial air transportation system. In response to this heightened levels of concern, companies throughout the nation have begun developing and implementing a variety of new security protocols intended to ensure employee safety and security. One security protocol being implemented by many businesses is to require certain key employees to fly exclusively on employer-provided aircraft, regardless of the business or personal nature of any individual flight. Under some circumstances, implementing such a security protocol can result in substantial tax savings.

Although the cost of *business* flights is typically paid by the employer, companies that implement a protocol that requires key employees to fly exclusively on employer-provided aircraft for all business or personal flights invariably must decide how to account for the cost of their employees' personal flights. The IRS generally requires that if an employee does not reimburse his or her employer for the cost of a personal flight, the employee must recognize fringe benefit income in an amount equal to the value of the flight. In many cases, however, the Federal Aviation Regulations will prohibit the employer from accepting reimbursement for such flights, and thus the imputation of fringe benefit income often is required by default.

The IRS regulations provide two primary means of determining the value of a personal flight for tax purposes: the "Fair Market Value" rule, and the "Non-Commercial Flight Valuation" rule. The Fair Market Value rule requires a valuation based on the cost to charter a similar flight on a similar in an arm's-length commercial charter transaction, while the Non-Commercial Flight Valuation rule, also known as the "Standard Industry Fare Level" rule and the "SIFL" rule, values flights by means of a mathematical formula that takes into account the position of the employee within the ownership and management structure of the employing organization, the weight class of the employer-provided aircraft used, the distance flown, and the number of relatives and guests that accompany the employee. However, where a protocol requiring certain employees to fly exclusively on employer-provided aircraft for all business or personal flights exists and certain other conditions are met, another IRS regulation known as the "Working Condition Safe Harbor" rule permits the employee to reduce one of the multiplication factors in the mathematical formula employed by the Non-Commercial Flight Valuation rule by either 331/3% or 50%, depending on the gross takeoff weight of the employer-provided aircraft. After all the math is done, the 331/3% or 50% reduction in the multiplication factor results in a net reduction in the value of the personal flight for tax purposes by nearly the same percentage.

The IRS regulations generally do not permit taxpayers to elect on a flight-by-flight basis to use either the Fair Market Value rule or the Non-Commercial Flight Valuation rule, but rather require that all personal flights during any given taxable year must be valued using the same method. The Working Condition Safe Harbor rule provides an except to the foregoing general rule by permitting the value of any personal flight falling within its scope to be determined under the Non-Commercial Flight Valuation

rule (as modified by the Working Condition Safe Harbor rule) regardless of whether the Fair Market Value rule or the Standard Industry Fare Level rule is used during the taxable year to value other non-qualifying personal flights.

Only "Control Employees" traveling on board employer-provided aircraft certified for a maximum gross takeoff weight greater than 10,000 lbs. may benefit from a reduced valuation under the Working Condition Safe Harbor valuation rule. Under IRS regulations, "Control Employees" are those employees who are (i) board or shareholder appointed, confirmed or elected officers; (ii) among the top one percent (1%) of highly compensated employees; (iii) owners of five percent (5%) or greater equity, capital or profits interest of the company; or (iv) directors of the company. Flights by non-Control Employees and flights by Control Employees using aircraft certified for a maximum gross takeoff of 10,000 lbs or less are already valued by the Non-Commercial Flight Valuation rule at rates well below the valuation provided by the Working Condition Safe Harbor, and consequently application of the Working Condition Safe Harbor valuation rule to such flights would actually result in a greater level of imputed income.

In order to qualify to use the Working Condition Safe Harbor to determine the value of a personal flight, two conditions must be satisfied. First, a specific bona fide business-related basis for concern for the safety of the employee whose flight is being valued must exist. The determination of whether a bona fide business-related basis for concern for the safety of an employee exists requires a facts and circumstances-based analysis; a mere general concern is insufficient.

Second, even if an actual basis for concern for the safety of the employees exists, the IRS will consider the business-related security concern to be bona fide only the employer establishes an overall security program satisfactory to the IRS with respect to the employee. The IRS regulations provide specific information regarding what constitutes a bona fide business-related security concern and what elements an overall security program must contain to be considered satisfactory by the IRS. Such information is too detailed and complex to be provided in this column. Persons potentially interested in establishing an aviation security program should contact our firm or other qualified aviation tax counsel to determine whether they may be able to benefit from the Working Condition Safe Harbor.

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