



REIMBURSEMENT FOR PERSONAL USE OF A BUSINESS AIRCRAFT: THE FAA VS. THE IRS

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To the busy executive, the corporate aircraft is a time multiplier. It allows the executive to travel and work at the same time, in complete privacy and security. Indeed, the recent decline in airline service has made the corporate aircraft an even more valuable business tool. These same considerations make the corporate aircraft a logical choice for the executive's personal travel as well. He can work or relax and (with satellite phones) is never out of touch with the company.

Almost anything an employee receives, as compensation is taxable. This includes non-cash benefits that an employee receives for free or for a reduced price. To the IRS, an executive's personal travel on a company aircraft is just another form of compensation. The same is true for travel by an executive's family or guests. As far as the IRS is concerned, the executive can pay fair market value (i.e., charter cost) for the travel or the value of the travel can be considered as a taxable fringe benefit and the value added to the executive's income.

The IRS recognizes two ways to determine the value of this fringe benefit: Fair market value or the special "SIFL" rules. SIFL stands for "standard industry fare level." SIFL valuations are periodically calculated and released by the U.S. Department of Transportation based upon the cost of airline travel. The IRS has adopted special rules for valuing personal travel on company airplanes that are based upon these SIFL values. As long as these special rules are followed, an executive's (and his family and guests') personal travel can be valued using the SIFL rules instead of the charter cost of the aircraft. In most cases, this results in a financially favorable result for the executive for two reasons. First, the

SIFL rules usually produce a cheaper price for the travel than the charter cost. In addition, the executive only pays a portion of the calculated value depending on his marginal tax rate. A good deal for the executive and historically most took advantage of it.

Recent events in the corporate world have made this alternative less attractive to senior corporate managers. Greater public scrutiny of the behavior of company executives has led to concern over the perception of "free" personal travel on the company jet. Stockholders watching their shares rapidly erode in value may not understand why the company's top managers should be able to fly off on vacation on the company's multi-million dollar airplane. For larger publicly traded companies (greater than \$10 million in assets or 500 shareholders), the SEC imposes specific requirements for disclosure of all annual and long-term compensation of top managers. These disclosure requirements include the value of any personal aircraft use above certain limits. This heightened scrutiny of "perks" such as personal travel has made many executives want to reimburse the company for their personal travel.

The IRS says this is OK, so no problem. Unfortunately, the FAA says "No way." According to the FAA, unless a company operates its aircraft under an FAA air carrier certificate, it may only receive compensation for travel on its aircraft when the travel is "incidental to and within the scope of" the company's business. Well, surely personal travel as compensation for an executive's efforts on behalf of the company's business meets this test. The FAA says it doesn't. In a 1993 legal interpretation, the FAA concluded that an executive's personal travel

on a company airplane was not “incidental to and within the scope of” the company’s business even though the company wanted the executive to travel on the company jet so it could promptly communicate with him. Thus, as far as the FAA is concerned, an executive cannot simply pay his company for his personal aircraft use.

Does this mean that an executive must accept travel as a taxable fringe benefit or forego personal use of the company jet? No, there are alternative structures that can avoid this result. What are some of these alternatives? If the company airplane is operated under the FAA’s charter rules, the executive can simply “charter” the airplane for personal flights. The

airplane can also be leased to the executive without a crew. As long as the executive does not use the company pilots, the FAA says this is permissible. Finally, the executive can enter into a “time sharing” arrangement with the company that lets him use the airplane and pay certain operating expenses. None of these alternatives is right for everybody and each contains pitfalls for the executive, the company, and the company’s pilots if not done correctly. However, with good advice from experienced aviation tax counsel, IRS, SEC, and FAA hurdles can all be safely cleared.



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