Maximizing Corporate Aircraft Tax Deductions Under The Jobs Creation Act

-By Keith G. Swirsky-

On May 27th, 2005, the IRS issued Notice 2005-45 ("Notice"). The Notice provides guidance on Section 274(e)(2) of the Internal Revenue Code, which was amended by the American Jobs Creation Act of 2004 ("Act"). Under the Act, expenses incurred after October 22nd, 2004 for entertainment, amusement or recreational ("recreation") use of a corporate aircraft are disallowed. The Notice addresses certain questions raised by the Act relating to the method of calculating the expense disallowance and provides guidance concerning how to allocate costs for flights in certain situations.

Neither the Act nor the Notice provides any insight into the meaning of "recreation" or when an aircraft is being used for recreational purposes. Instead, the Notice refers to Treasury Regulations that purport to define whether an aircraft will be treated as a recreational facility. Regrettably, these regulations are not helpful. What is clear, however, is that the IRS has verbally agreed, in follow-up meetings with representatives of the National Business Aircraft Association, that certain personal use of a corporate aircraft may not rise to the level of "recreation", and therefore taxpayers will continue to be entitled to a full deduction for expenses associated with personal non-recreational use of an aircraft.

Those of us tracking these developments believe that the IRS will issue proposed regulations, and such regulations will confirm that there is a category of personal non-recreational use that would not be subject to the disallowance provisions of Code Section 274(e)(2). These proposed regulations will likely define three categories of use of a corporate aircraft: business use, personal recreational use, and personal non-recreational use; and require taxpayers to track the three types of use for purposes of determining disallowance of deductions. It is also likely that the IRS will not provide enough detailed specifics on what falls into the category of personal non-recreational use. Any flight activity that falls into this category will be treated as business use for purposes of determining the disallowance of corporate deductions. . . . and will maximize such deductions.

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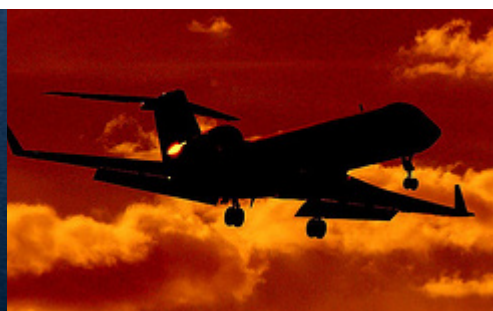

Until such time as the IRS provides further guidance in this area, aircraft owners should apply a reasonable methodology for determining if a flight is personal non-recreational for a particular individual on board a flight. Examples of flights that should be personal non-recreational, include flights taken by an individual for the following purposes: oversight of a personal investment portfolio; charitable activities; a trip to visit sick relatives, attend a funeral or drop a child off at college; attendance at a meeting as a board member of an unrelated company; and lastly, and perhaps most importantly, commuting between personal residences and commuting to work.

On the issue of commuting between residences, it is necessary to look at the purpose of the trip. For example, if an individual's residence is at a ski resort in Telluride, Colorado, then it is likely that commuting to that residence would be deemed personal recreational. In contrast, if the residence is located in Minneapolis, and an individual prefers the climate and social environment, but spends the majority of his or her time working while located in Minneapolis, it is likely that such commuting would be deemed personal non-recreational.

It is important to note that categorizing use as personal non-recreational is a matter of subjective interpretation that falls under the heading of "thoughtful planning". Pending the IRS issuing guidelines in this matter, there is a significant planning opportunity to interpret the Act and the Notice in a taxpayer friendly manner. Of course, it would be prudent to keep detailed records for each individual on-board a corporate aircraft supporting the characterization of the purpose of the flight as personal non-recreational.

In order to substantiate tax return preparation, it will be necessary to create a flight log record on a leg-by-leg basis containing far more detailed information than has been kept in the past. The ability to support personal non-recreational use, combined with the need to accurately report imputed income associated with personal use, suggests that more education in these areas is required for the individuals in charge of this record keeping process. These records will be impossible to reconstruct after the fact, so it is imperative that you review your situation with a qualified aviation professional. Galland, Kharasch, Greenberg, Fellman & Swirsky has been disseminating information on these issues since the publication of the Act and the Notice and continues to provide helpful guidance to aircraft owners on a daily basis.