



Personal & Entertainment Use of Business Aircraft ***Federal Income & Excise Tax Implications***

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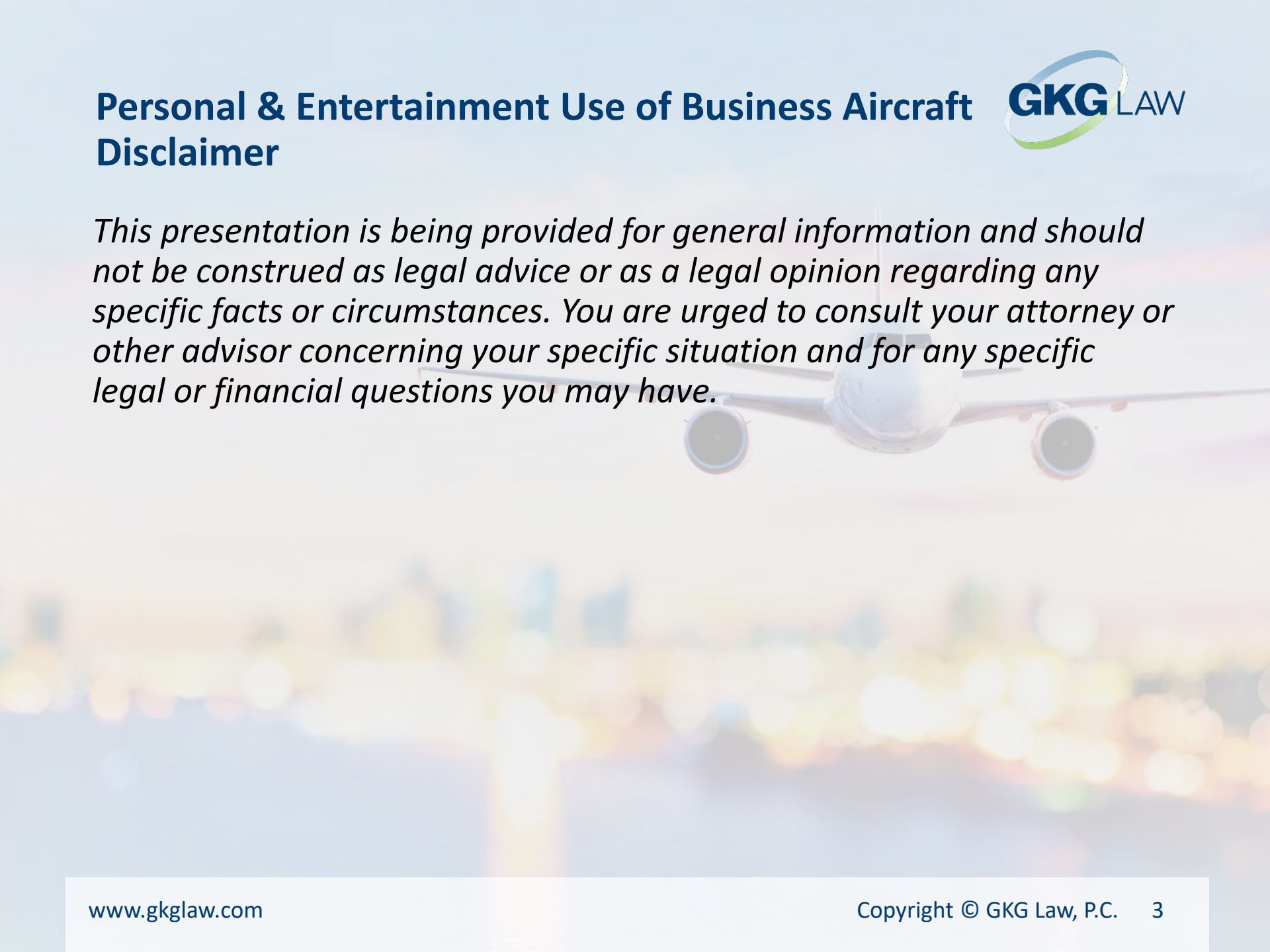
114 First Street South
Buffalo, Minnesota 55313

Upcoming Webinars

Sales & Use Taxes on Aircraft: Latest Developments & Key Planning Tools	December 17, 2020 1 pm ET
Federal & State Tax Audit Defense	January 21, 2021 1 pm ET

Personal & Entertainment Use of Business Aircraft Disclaimer

This presentation is being provided for general information and should not be construed as legal advice or as a legal opinion regarding any specific facts or circumstances. You are urged to consult your attorney or other advisor concerning your specific situation and for any specific legal or financial questions you may have.

A blurred background image of a white business jet flying over a city at night, with bokeh lights from buildings and streets visible in the distance.

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About Us

- ✓ Aircraft Purchase & Sale Transactions
- ✓ Aircraft Ownership & Operating Structures
- ✓ Federal & State Tax Planning
- ✓ Structuring Aircraft Financing
- ✓ IRS, State & FAA Audits & Enforcement Actions
- ✓ Aircraft Personal Use Guidelines
- ✓ Analysis & Preparation of Fringe Benefit Income Imputation & Entertainment Disallowance Calculations
- ✓ Structuring Aircraft Ownership Trusts

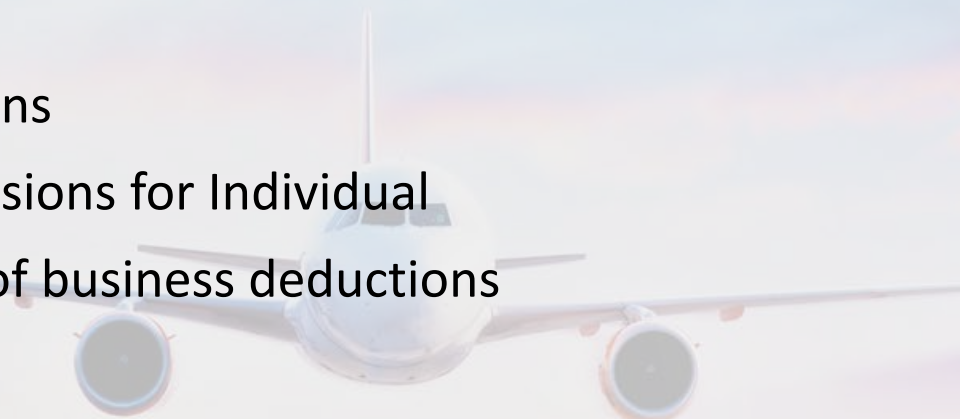
Personal & Entertainment Use of Business Aircraft



▶ Federal Tax Planning Considerations

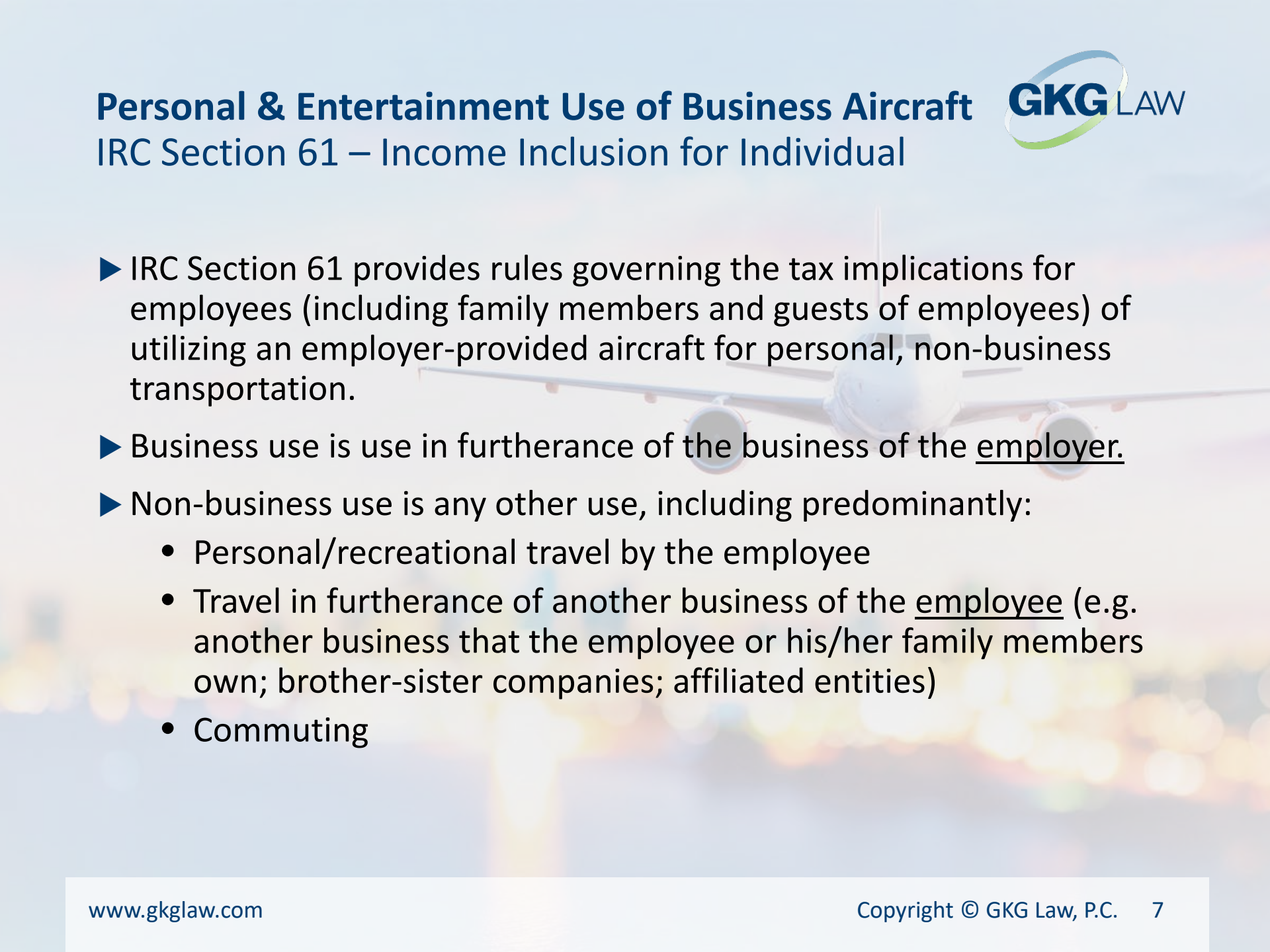
- IRC Section 61 – Income inclusions for Individual
- IRC Section 274 – Limitation of business deductions

▶ FAA Regulatory Considerations



Personal & Entertainment Use of Business Aircraft

IRC Section 61 – Income Inclusion for Individual

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- ▶ IRC Section 61 provides rules governing the tax implications for employees (including family members and guests of employees) of utilizing an employer-provided aircraft for personal, non-business transportation.
 - ▶ Business use is use in furtherance of the business of the employer.
 - ▶ Non-business use is any other use, including predominantly:
 - Personal/recreational travel by the employee
 - Travel in furtherance of another business of the employee (e.g. another business that the employee or his/her family members own; brother-sister companies; affiliated entities)
 - Commuting

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FAA Regulatory Considerations: General Rule

As a general rule, if a person or company uses a business aircraft to provide air transportation to another person or company and receives any form of compensation for the provision of the air transportation, the person or company operating the aircraft must have an air carrier or commercial operator certificate and must operate the flight under 14 CFR Part 135.

- ▶ There are several exceptions to the general rule.
- ▶ The general rule applies equally to owners, affiliates, employees, guests, etc., in addition to third-parties, unless an exception applies.

Personal & Entertainment Use of Business Aircraft Exceptions to FAA General Rule: Dry Lease Structure

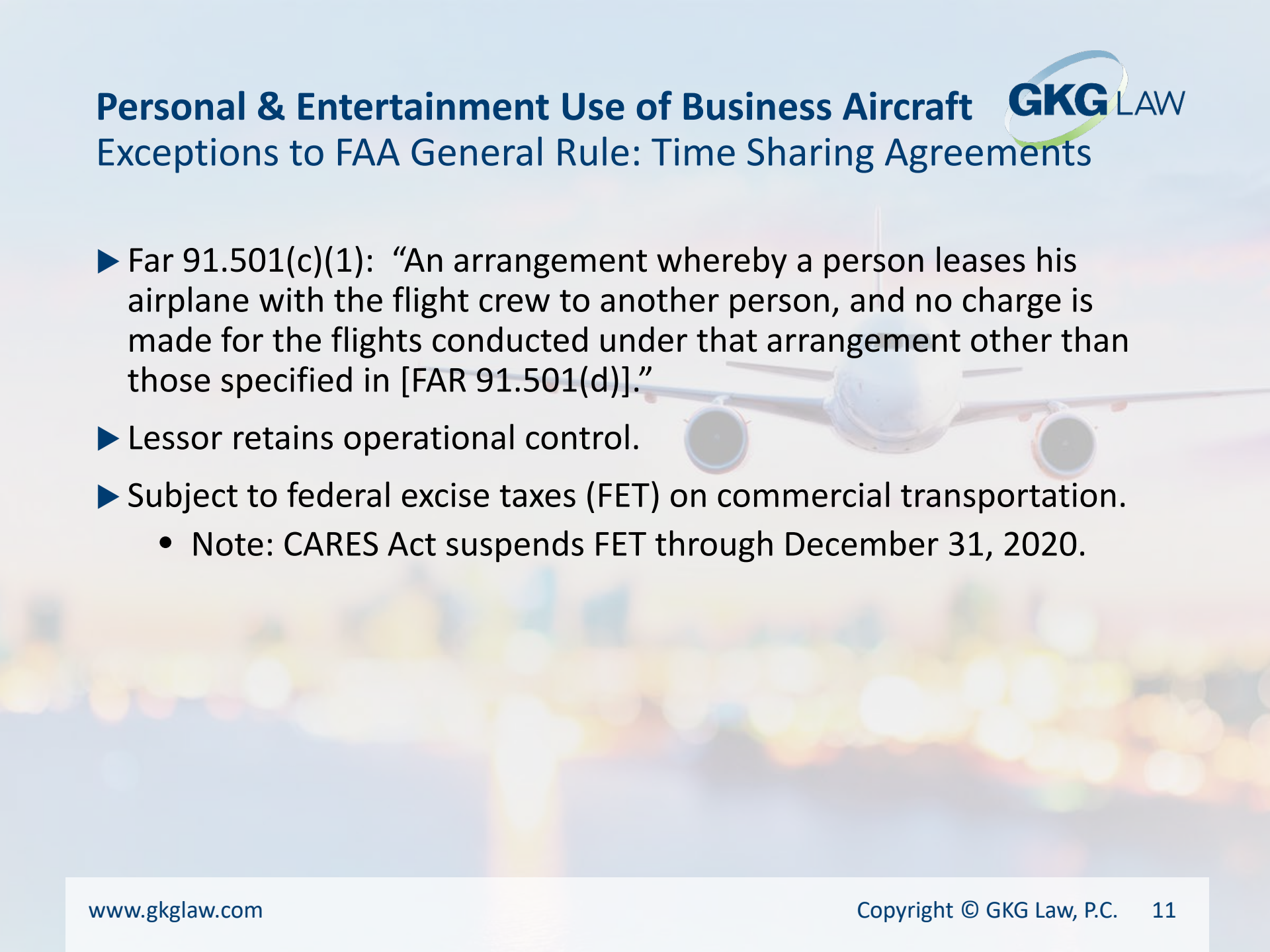
- ▶ Lease of aircraft without pilots.
- ▶ No limit on rent that may be charged.
- ▶ Lessee must contract for, and pay for, pilot services from a source independent of the Lessor.
- ▶ Lessee assumes operational control of aircraft and is responsible/potentially liable.
- ▶ Not subject to federal excise taxes on commercial transportation.
- ▶ Generally subject to state use taxes.

Personal & Entertainment Use of Business Aircraft Exceptions to FAA General Rule: Within Scope of, & Incidental to Business of the Company

- ▶ FAR 91.501(b)(5) permits a company to provide transportation to its “officials, employees, and guests ... on an airplane operated by that company, or the parent or a subsidiary of the company or a subsidiary of the parent, *when the carriage is within the scope of, and incidental to, the business of the company (other than transportation by air),* and no charge, assessment, or fee is made for the carriage in excess of the cost of owning, operating, and maintaining the airplane.
 - FAR 91.501(b)(5) prohibits charges of any kind for transportation provided to guests of a company when not within the scope of and incidental to the business of the company.
 - Shareholders, Members, Directors, Officers, Managers, Employees, etc., are considered guests of a company when traveling for personal, non-business purposes, and such travel is not within the scope of and incidental to the business of the company for purposes of FAR 91.501(b)(5).

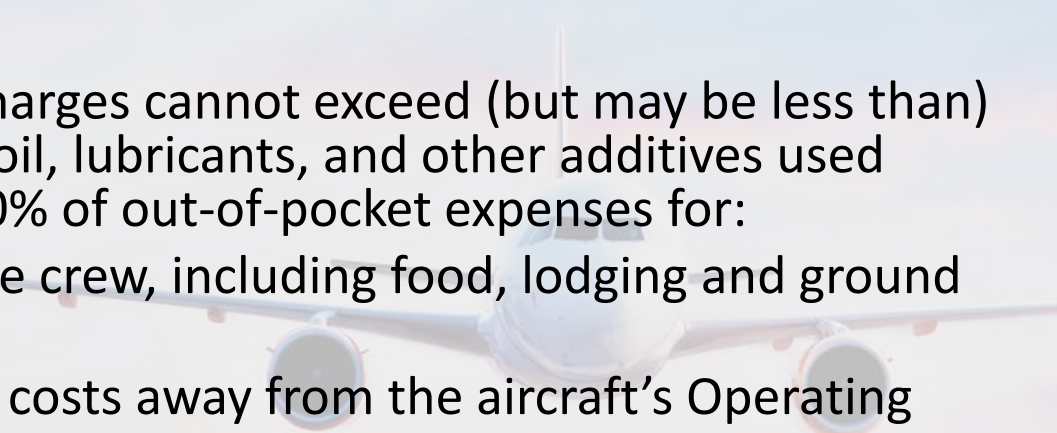
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Exceptions to FAA General Rule: Time Sharing Agreements

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- ▶ Far 91.501(c)(1): “An arrangement whereby a person leases his airplane with the flight crew to another person, and no charge is made for the flights conducted under that arrangement other than those specified in [FAR 91.501(d)].”
 - ▶ Lessor retains operational control.
 - ▶ Subject to federal excise taxes (FET) on commercial transportation.
 - Note: CARES Act suspends FET through December 31, 2020.

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Exceptions to FAA General Rule: Time Sharing Agreements

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- A faint, semi-transparent image of a commercial airplane in flight, viewed from a low angle, serves as a background for the text.
- ▶ FAR 91.501(d): Permits charges cannot exceed (but may be less than) 200% of the cost of fuel, oil, lubricants, and other additives used during the flight, plus 100% of out-of-pocket expenses for:
 - Travel expenses of the crew, including food, lodging and ground transportation
 - Hangar and tie down costs away from the aircraft's Operating Base
 - Insurance obtained for the specific flight
 - Landing fees, airport taxes and similar assessments
 - Customs, foreign permit, and similar fees directly related to the flight
 - In-flight food and beverages
 - Passenger ground transportation
 - Flight planning and weather contract services

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IRC Section 61 – Income Inclusion for Individuals

- ▶ **IRS Rule for Personal Transportation:** Employer must impute fringe benefit income to the employee for the amount by which the *value* of the transportation provided **exceeds** the **amount paid** by the employee for the transportation.
- ▶ **Two methods to determine *value*** of the transportation for fringe benefit purposes:
 - Fair charter value method
 - Standard industry fare level (SIFL) method

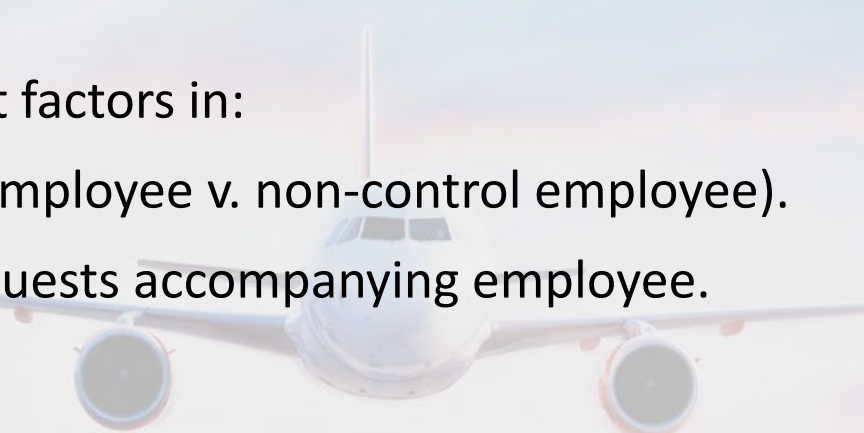
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Fair Charter Value

- ▶ Value of personal travel equal to the arm's-length cost to charter a similar aircraft for the flight.
- ▶ Allocate fair charter value of the flight among all employees on the aircraft unless some have the ability to control the use of the aircraft (e.g., senior execs) and others do not, in which case value is allocated among only those employees who have the ability to control the use of the aircraft.
- ▶ A company that uses the fair charter value method must use it for all personal flights for the year.

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SIFL Formula

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- A photograph of a white business jet aircraft in flight, viewed from a low angle looking up. The aircraft is centered in the upper half of the slide. The background is a blurred cityscape at night with warm, bokeh-style lights.
- ▶ Simple mathematical formula that factors in:
 - Status of employee (control employee v. non-control employee).
 - Number of family members/guests accompanying employee.
 - Weight class of aircraft.
 - Distance flown (straight-line distance; statute miles).
 - ▶ Applied separately to each employee on each flight leg (except ignore intermediate stops unrelated to personal purposes (e.g., fueling stops)).

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SIFL Formula

- ▶ The SIFL formula also includes cents-per-mile rates and terminal charges that are adjusted and published semi-annually by the U.S. Department of Transportation (DOT).
- ▶ These “SIFL Rates”, are generally republished by the IRS in revenue procedures shortly after publication by the DOT and are usually posted on the web site of the National Business Aviation Association (www.nbaa.org).



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SIFL Rates 7/01/20 - 12/31/20

0-500 Miles: \$0.2331 per mile

501-1,500 Miles: \$0.1778 per mile

Over 1,500 Miles: \$0.1709 per mile

Terminal Charge: \$42.62

Personal & Entertainment Use of Business Aircraft SIFL Formula Aircraft Multipliers

Aircraft Max T.O. Weight	Control Employee	Non Control Employee
Up to 6,000 lbs.	62.5%	15.6%
6,001 – 10,000	125%	23.4%
10,001 – 25,000	300%	31.3%
25,001 or greater	400%	31.3%

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Defining the Flight to be Valued Under SIFL

- ▶ The SIFL formula is applied on a flight-by-flight basis, with each takeoff and landing being treated as a single flight.
 - A round-trip flight is treated as two separate flights.
 - Similarly, a one-way trip with a stopover at an intermediate destination is treated as two separate flights, unless the intermediate stop is made for any reason unrelated to the personal purposes of the employee whose flight is being valued.
 - Ferry flight legs are not subject to imputed income.

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Defining the Flight to be Valued Under SIFL

- ▶ Where a flight is provided to an employee to a particular destination for a combination of personal and business purposes, income is imputed only if the personal purpose of the flight is primary.
- ▶ The determination of whether a flight is primarily for personal or business purposes is based on a facts and circumstances analysis.

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Special Rules: Mixed Business & Personal Trips

- ▶ Single destination for both business and personal purposes: primary purpose controls.
- ▶ Single trip with separate business and personal destinations: determine primary purpose of trip as a whole:
 - Trip primarily business: SIFL miles = actual miles flown in excess of miles of hypothetical trip that includes only business destinations.
 - Trip primarily personal: SIFL miles = miles of hypothetical trip that includes only personal destinations.
- ▶ Primary purpose analysis based on facts and circumstances.

Personal & Entertainment Use of Business Aircraft

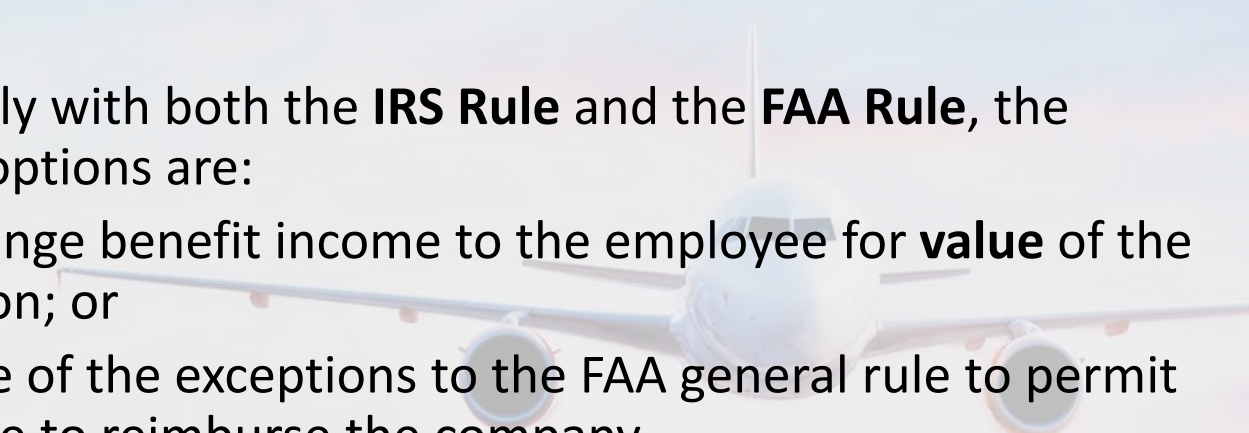
Special Rules: Seating Capacity

If individuals traveling for the employer's business occupy at least 50% of the regular passenger seating capacity of the aircraft, then:

- ▶ The SIFL value of travel by employees, spouses and dependents is \$0.
- ▶ The SIFL value of travel by non-employees is at the non-control employee rates.

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IRC Section 61 – Income Inclusion for Individuals

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- A large commercial aircraft is shown in flight, viewed from a low angle looking up. The plane is white with blue accents on the tail and engines. The background is a soft, out-of-focus sky with some light trails, suggesting motion or a long exposure shot.
- ▶ In order to comply with both the **IRS Rule** and the **FAA Rule**, the company's only options are:
 - To impute fringe benefit income to the employee for **value** of the transportation; or
 - To utilize one of the exceptions to the FAA general rule to permit the employee to reimburse the company.
 - ▶ If the amount paid by an employee for personal is less than the value of the transportation (e.g., as determined under SIFL), the employer must impute income for the amount of the difference. This is most likely to occur in situations where all, or nearly all, of the seats on the aircraft operated under a Time Sharing Agreement are occupied by family members or guests of an employee.

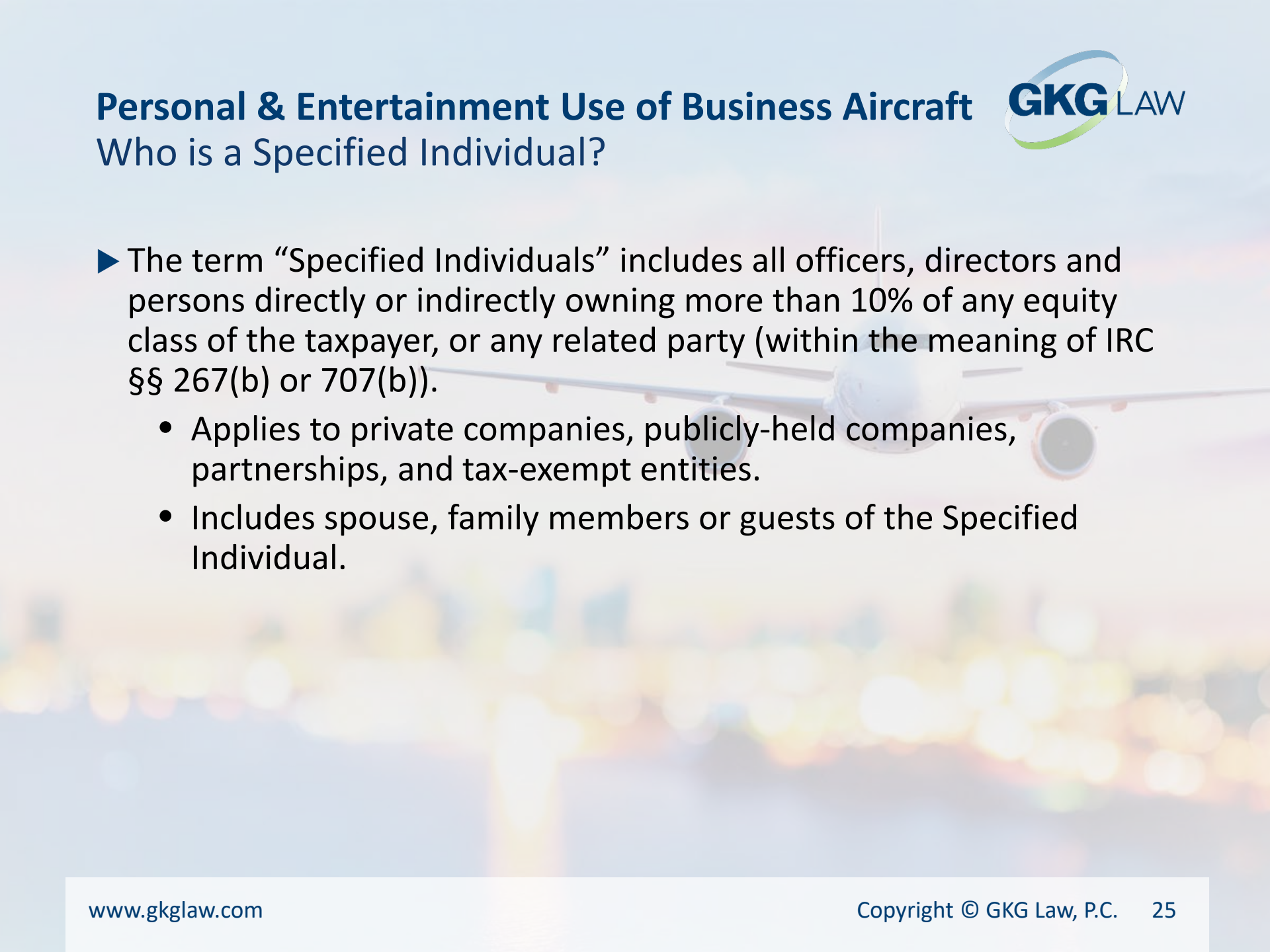
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IRC Section 274 – Limitation of Business Deductions

- ▶ Section 274 of the tax code limits deductions for expenses of **facilities** used for entertainment, amusement or recreational purposes & commuting (except as necessary to ensure the safety of the employee).
- ▶ A business aircraft is considered to be such a facility; the law applies to such use of an aircraft by “Specified Individuals.”
- ▶ Requires that expenses and depreciation be allocated to business travel and entertainment/commuting travel on a pro rata basis and denies or limits deductions for expenses and depreciation allocated to entertainment/commuting.
 - Consider effects of entertainment/commuting use on bonus depreciation in the year the aircraft is placed in service.

Personal & Entertainment Use of Business Aircraft

Who is a Specified Individual?

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- ▶ The term “Specified Individuals” 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)).
 - Applies to private companies, publicly-held companies, partnerships, and tax-exempt entities.
 - Includes spouse, family members or guests of the Specified Individual.


Personal & Entertainment Use of Business Aircraft

What is Entertainment/Commuting?

- ▶ Sports Events
 - ▶ Hunting
 - ▶ Fishing
 - ▶ Golfing
 - ▶ Travel to Country Clubs
 - ▶ Skiing
 - ▶ Resort Destinations
 - ▶ Travel between an employee's residence and place of business
- 
- A large commercial airplane is shown from a front-on perspective, flying over a city at night. The city lights are blurred in the background, creating a bokeh effect. The airplane is white with two engines visible under the wings.

Personal & Entertainment Use of Business Aircraft

Personal Activities that are Not Entertainment

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- A white business jet is shown from a front-on perspective, flying towards the viewer. The background is a blurred cityscape at night, with numerous warm, yellow and orange bokeh lights from buildings and streetlights. The overall scene is set against a light blue sky.
- ▶ Travel to a funeral
 - ▶ Travel for medical purposes
 - ▶ Travel for charity work
 - ▶ Travel for business other than that of the employer providing the flight
 - ▶ Travel to meeting with personal advisors
 - ▶ Transportation between homes not associated with entertainment

Personal & Entertainment Use of Business Aircraft

Travel for Both Business & Recreational Purposes

Single Destination

- ▶ IRS regulations do not address how to determine whether a Specified Individual's trip to a particular destination should be categorized as business or entertainment when both activities are conducted.
- ▶ Other 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, it should be reasonable to assume that a similar methodology may be used.

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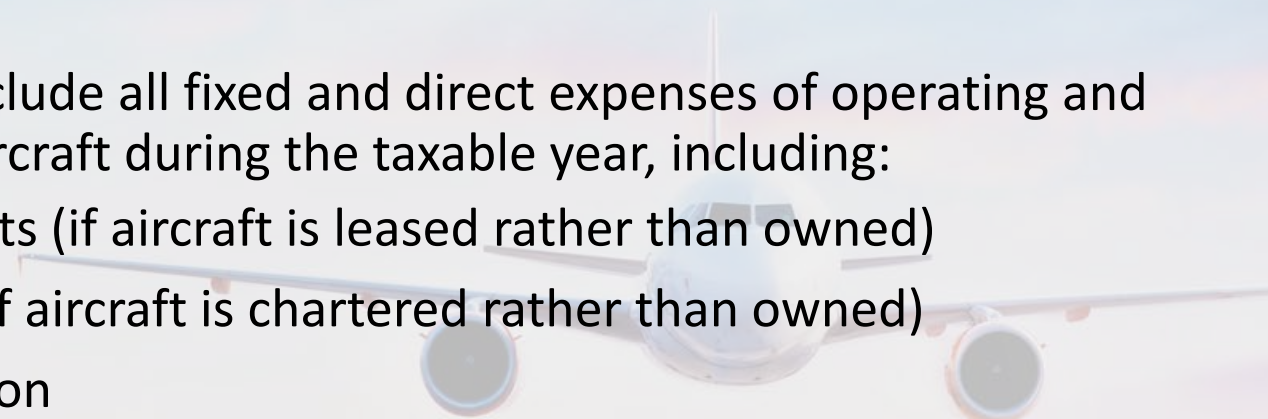
Travel for Both Business & Recreational Purposes

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.

Personal & Entertainment Use of Business Aircraft

What Expenses are Disallowance?

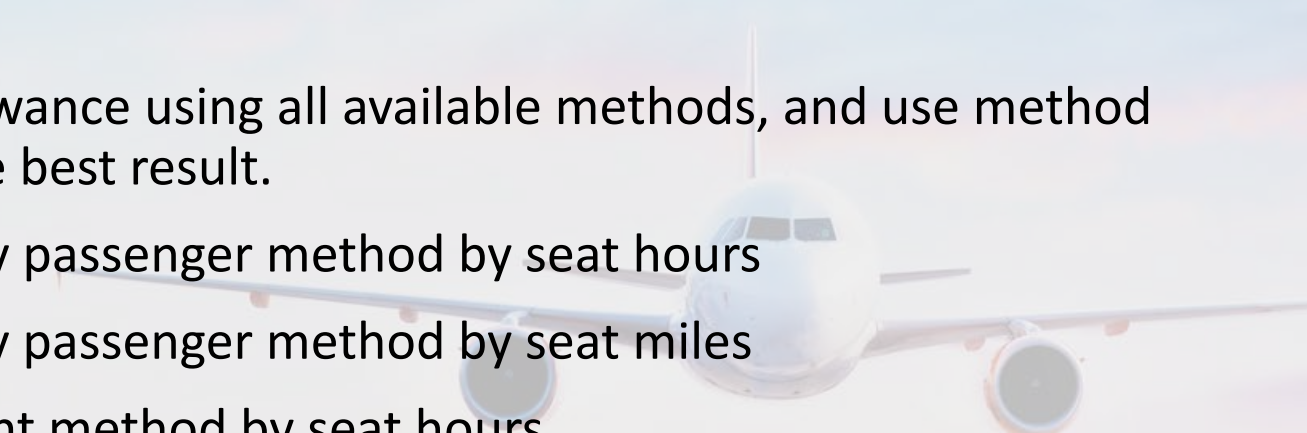
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- A blurred image of a commercial aircraft in flight, viewed from a low angle, with its landing gear extended. The background is a soft-focus bokeh of warm, yellow and orange lights, suggesting a sunset or airport lights at dusk.
- ▶ Taxpayers must include all fixed and direct expenses of operating and maintaining the aircraft during the taxable year, including:
 - Lease payments (if aircraft is leased rather than owned)
 - Charter fees (if aircraft is chartered rather than owned)
 - Tax Depreciation
 - Interest “properly allocable” to an aircraft, under the interest tracing rules

Personal & Entertainment Use of Business Aircraft Special Rules Regarding Depreciation Expense

- ▶ Taxpayers may elect to calculate depreciation using the ADS straight-line method over the class life of the aircraft solely for purposes of calculating the amount of the disallowed expense, even if another method is used for tax or book purposes.
- ▶ The election may be made for aircraft placed in service in prior years. In such cases, apply straight-line to original basis as if the election had been in effect since the aircraft was placed in service.
- ▶ If taxpayer elects to use the straight-line method for one aircraft, it must use the method for all aircraft it owns.

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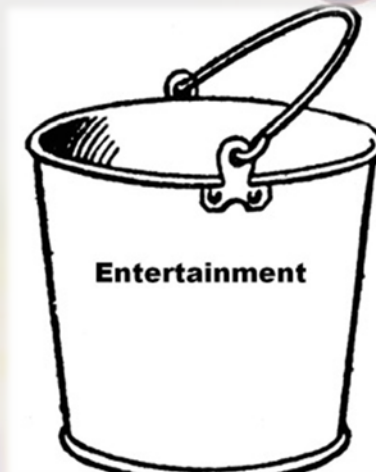
Methodologies for Calculating Disallowance of Aircraft Expense Deductions

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- A photograph of a white commercial airplane in flight, viewed from a low angle. The plane is centered in the upper half of the frame, with its wings and engines clearly visible. The background is a soft-focus view of a city at night, with numerous lights creating a bokeh effect.
- ▶ Calculate disallowance using all available methods, and use method that provides the best result.
 - Passenger by passenger method by seat hours
 - Passenger by passenger method by seat miles
 - Flight by flight method by seat hours
 - Flight by flight method by seat miles

Personal & Entertainment Use of Business Aircraft

Record Keeping & Calculations Under Passenger 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 three buckets.



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Record Keeping & Calculations Under Passenger Seat Hour/Seat Mile Methods

Assume five passengers on board (all Specified Individuals), three of whom are traveling on business non-entertainment, one is traveling for entertainment/commuting, and one 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 Non-Entertainment	3	1,000	3,000
Entertainment/Commuting	1	1,000	1,000
Personal Non-Entertainment	1	1,000	1,000

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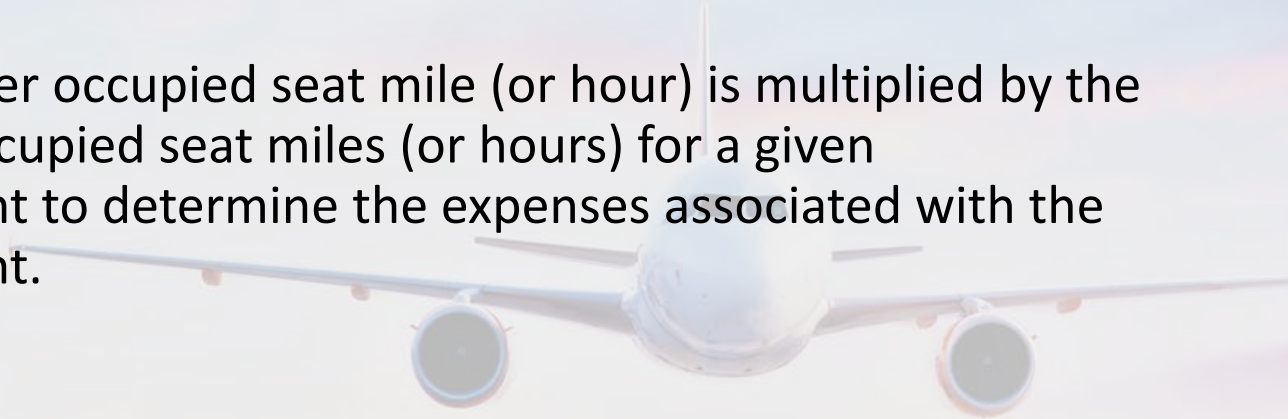
Record Keeping & Calculations Under Passenger Seat Hour/Seat Mile Methods

- ▶ 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 three buckets.
- ▶ The average cost per occupied seat mile (or hour) for the taxable year is determined.

Personal & Entertainment Use of Business Aircraft

Allocating Expenses to Business & Entertainment Uses Under Passenger Seat Hour/Seat Mile Methods

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



Personal & Entertainment Use of Business Aircraft

Allocating Expenses to Business & Entertainment Uses Under Passenger Seat Hour/Seat Mile Methods

- ▶ The total amount imputed as income to, or reimbursed by, the Specified Individual for each individual 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.

Personal & Entertainment Use of Business Aircraft Record Keeping

- ▶ At Audit, IRS may assume **ALL** aircraft use is personal **AND** entertainment, **unless taxpayer proves otherwise.**





Questions?

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