PERSONAL USE FLIGHTS: INCOME TAX CONSEQUENCES TO SHAREHOLDERS AND EMPLOYEES

By Troy A. Rolf

Presented by Keith G. Swirsky

Galland, Kharasch, Greenberg, Fellman & Swirsky, P.C.
1054 Thirty-First Street, N.W., Suite 200
Canal Square
Washington, D.C. 20007

Tel: (202) 342-5251; Fax: (202) 965-5725
kswirsky@gkglaw.com

PERSONAL USE FLIGHTS: INCOME TAX CONSEQUENCES TO SHAREHOLDERS AND EMPLOYEES

A. INTRODUCTION

Aircraft owned and operated by corporations and other business entities are occasionally, and sometimes exclusively, used to provide transportation services to directors, officers, and employees of the entities for personal, rather than business, purposes. One of the perceived benefits of owning and operating a business aircraft is that the aircraft may be used by selected individuals for transportation not only to business meetings, but to personal and leisure destinations as well. In fact, business-owned aircraft commonly grace airport parking ramps at virtually every popular vacation destination.

Personal use of business aircraft entails certain tax consequences. Precisely what those consequences will be depends on a number of factors. For example, will the aircraft be provided to the employee with or without a flight crew, and will the employee be required to compensate the company for the use of the aircraft?

When an aircraft is made available for the personal use of a director, officer, or employee of a company, and the director, officer, or employee does not pay full value for the use of the aircraft, such use of the aircraft may constitute a fringe benefit taxable to the director, officer, or employee as ordinary income.

The discussion that follows addresses the issue of the imputation of fringe benefit income in respect of personal use of business aircraft by shareholders, directors, officers, and employees. The discussion first addresses the methods by which the amount of income to be imputed may be determined. Next, the discussion addresses rules governing mixed-use (business and personal) flights and the consistency rules. Last, the discussion addresses permitted methods for reducing the amount of income that must be imputed to directors, officers, and employees.

B. VALUATION RULES

The Internal Revenue Code specifies that a taxpayer's gross income includes fringe benefits received as compensation for services.[1] Treasury regulations generally provide that the value of a fringe benefit for purposes of determining gross income equals the amount by which the fair market value of the fringe benefit exceeds the sum of the amount, if any, the recipient paid for the benefit, plus the amount, if any, the recipient may exclude from gross income under any other provision of Subtitle A of the Internal Revenue Code.[2] From this regulation, it is clear that the method by which a value for a fringe benefit is determined may greatly affect the income tax liability of the recipient of the fringe benefit. Three specific valuation methods are relevant in the business aviation context: the fair market valuation rule for use of an employer-provided aircraft for which the employer does

[1] I.R.C. § 61(a)(1).

[2] Treas. Reg. § 1.61-21(b).

not provide a pilot[3]; the fair market valuation rule for flights on an employer-provided piloted aircraft[4]; and the "Non-commercial Flight Valuation Rule". Each of these is discussed separately below.

1. Fair Market Valuation Rule (Dry Lease)

Occasionally a business entity that owns or operates a business aircraft will provide such aircraft to a director, officer, or employee of the company without a flight crew on a Dry Lease basis. The lease of the aircraft may or may not be pursuant to a written lease document.[5] This type of transaction is probably most common where the lessee-director, lessee-officer, or lessee-employee is properly licensed and qualified to operate the aircraft personally, but in some situations, a lessee-director, lessee-officer, or lessee-employee may separately contract for the services of a qualified pilot. However, if the lessee-director, lessee-officer, or lessee-employee employs the same pilot who normally operates the aircraft for the lessor, the transaction may be deemed to be a Wet Lease notwithstanding the formal separation of the aircraft lease and the pilot employment agreement into separate transactions.

The fair market value of the use of an aircraft without a flight crew, for fringe benefit purposes, is equal to the amount that an individual would have to pay in an arm's length transaction to lease the same or comparable aircraft on the same or comparable terms for the same period in the geographic area in which the aircraft is used.[6] If a use of the aircraft benefits more than one employee, the value of the flight is allocated among the employees benefitted on the basis of the relevant facts and circumstances.[7]

2. Fair Market Valuation Rule (Wet Lease)

The rules for valuing a personal-use flight of a business aircraft, where the aircraft is provided to an employee with a flight crew, are similar to the rules governing the provision of an aircraft without a crew, to the extent that the value is determined by reference to the amount that an individual would have to pay in an arm's length transaction to charter the same or a comparable piloted aircraft for that period for the same or a comparable flight, and that if a flight of the aircraft

---

[3] Hereinafter the "Fair Market Valuation Rule (Dry Lease)".

[4] Hereinafter the "Fair Market Valuation Rule (Wet Lease)".

[5] If the aircraft is registered in the United States and has a maximum certificated takeoff weight in excess of 12,500 lbs., a written lease will be required. *See* 14 C.F.R. 91.23.

[6] Treas. Reg § 1.61-21(b)(7)(ii).

[7] *Id.*

benefits more than one employee, the value of the flight is generally allocated among the employees benefitted on the basis of the relevant facts and circumstances.[8] However, if more than one employee is on board the flight, and the employees can be divided into two categories, one of which includes one or more employees who have the authority to determine the route, departure time, and destination of the flight, and one which includes one or more employees who do not have such power, the general rule that the entire value of the flight is allocated among the employees benefitted on the basis of the relevant facts and circumstances is overruled, and in lieu thereof, the entire value of the flight is allocated among those employees with the authority to determine the route, departure time, and destination of the flight. No portion of the value of the flight is allocated to those employees without such authority, unless all the employees on the flight have agreed in writing to allocate the value of the flight on some other basis.[9]

3. Noncommercial Flight Valuation Rule

The Treasury Regulations provide an alternative to the Fair Market Valuation Rule (Wet Lease). This alternative valuation method is a formulaic method based on the Standard Industry Fare Level[10] rates published semiannually by the United States Department of Transportation,[11] and hence is commonly referred to as the "Standard Industry Fare Level method", or simply the "SIFL

---

[8] Treas. Reg § 1.61-21(b)(6)(ii). Treas. Reg. § 1.61-21(b)(6)(ii) specifically prohibits the use of commercial airfare as a measure of the value of flight on an employer-provided piloted aircraft.

[9] *Id.*

[10] Hereinafter "SIFL".

[11] The Airline Deregulation Act of 1978, Pub. L. 95-504, mandated that the Civil Aeronautics Board establish a Standard Industry Fare Level based upon airline fares in effect on July 1, 1979, and that the Civil Aeronautics Board periodically update the Standard Industry Fare Level by the percentage change in airline average operating costs per available seat-mile ("available seat-miles" are calculated on a flight-by-flight basis by dividing the total number of miles on the route of flight by the number of seats on board the aircraft available for sale to the public). The Civil Aeronautics Board used the Standard Industry Fare Level as a standard against which a statutory zone of reasonableness was measured until the Civil Aeronautics Board's authority to regulate passenger fare expired on January 1, 1983, and hence the Standard Industry Fare Level is technically obsolete for the purpose for which it was established. However, the Department of Transportation continues to adjust the Standard Industry Fare Level semiannually for use as an aid in evaluating air carrier pricing in the present unregulated environment.

method."[12]

Use of the SIFL method usually results in significantly less income being imputed to the employee than would otherwise be imputed under the Fair Market Valuation Rule (Wet Lease). A reduced imputed income amount is most likely to occur if the employee is not a Control Employee[13] and travels alone or with only a small number of family members and other guests. However, the SIFL method can result in more income being imputed to the employee than would be imputed under the Fair Market Valuation Rule (Wet Lease) in some circumstances, such as where a Control Employee travels accompanied by a large number of family members and other guests. The reason for this is two-fold. First, the SIFL method requires that income be imputed to Control Employees at rates substantially higher than to Non-Control Employees. Second, subject to a few exceptions discussed below, the SIFL method requires that income be imputed to the employee not only for transportation provided to the employee, but also on a per-person basis for transportation provided to family members and guests who accompany the employee. Thus, the amount that would be imputed to the employee if he or she traveled alone would be doubled if the employee was accompanied by one family member or guest, tripled if the employee was accompanied by two family members or guests, and so on. As the number of family members and guests multiplies, the amount imputed to the employee increases by the same factor.

Conversely, under the Fair Market Valuation Rule (Wet Lease), the amount of income imputed to the employee would generally be fixed regardless of whether the employee was a Control Employee or a Non-Control Employee, and regardless of whether the employee traveled accompanied by family members or guests. As stated in the previous section of this article, the amount that must be imputed to an employee under the Fair Market Valuation Rule (Wet Lease) is determined in relevant part by reference to the amount that an individual would have to pay in an arm's length transaction to charter the same or a comparable piloted aircraft for that period for the same or a comparable flight. In contrast to the commercial airline industry which generally charges fares on a per-seat basis, commercial charter operators typically charge a flat hourly rate for exclusive use of an aircraft or quote a flat fee for a particular flight, and such fees generally are charged without regard to the number of passengers who will accompany the charter customer.

a. The Aircraft Valuation Formula

---

[12] Treasury regulations provide that in the event the calculation of the Standard Industry Fare Level is discontinued, the Commissioner of the IRS may provide a different base aircraft valuation formula by regulation, revenue ruling, or revenue procedure. Treas. Reg. § 1.61-21(g)(6).

[13] *See* definitions of "Control Employee" and +Non-Control Employee" *infra* Part IV.B.3.a.(4).

In order to calculate the value of a flight using the SIFL method, several factors must be considered. Each factor is discussed below.

(1) Define the Flight to be Valued

The Aircraft Valuation Formula is applied on a flight by flight basis, with each takeoff and landing being treated as a single flight.[14] Thus, 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.

> *Example:* an employer provides personal, non-business related air transportation to an employee from New York to Los Angeles with a stopover in Chicago. The stopover in Chicago was made for purposes personal to the employee.
>
> For purposes of calculating the value of the flight under the SIFL method, the trip is treated as consisting of two separate flights, i.e., one flight from New York to Chicago, and another flight from Chicago to Los Angeles.

[14] Treas. Reg. § 1.61-21(g)(3)(ii).

An exception to the foregoing rule applies to intermediate stops conducted for any reason unrelated to the personal purposes of the employee whose flight is being valued. If the stop is conducted for any reason unrelated to the personal purposes of the employee whose flight is being valued, including intermediate stops necessitated by weather conditions or emergencies, intermediate stops to disembark passengers other than those for whom the value of the flight is being calculate, or stops for refueling or other aircraft-servicing purposes, the intermediate stop is ignored, and the flight is valued as if the intermediate stop had not occurred.[15]

> *Example:* same facts as the previous example, except that the sole purpose of the stopover in Chicago was to refuel the aircraft.
>
> For purposes of calculating the value of the flight under the SIFL method, the trip is treated as consisting of a single non-stop flight from New York to Los Angeles.

(2) Determine Mileage of Flight

For purposes of calculating the value of a flight under the SIFL method, distance is measured as the number of statute miles between the origin and destination points of a flight.[16] Additional mileage flown resulting from any intermediate stop conducted for any reason unrelated to the personal purposes of the employee whose flight is being valued is ignored. Similarly, where actual mileage flown between two points exceeds the straight-line distance between such points, such as would be the case if the route of flight is diverted off a direct course by air traffic control or in order to avoid areas of inclement weather or restricted airspace, the additional mileage flown in excess of the straight-line distance between the points of embarkation and disembarkation is ignored.

(3) Determine Weight of Aircraft

The amount of income imputed to an employee is determined in part by the weight of the aircraft used. The Treasury Regulations divide all aircraft into four classes according to the maximum certified takeoff weight of each aircraft.[17] The four weight classes are as follows:

---

[15] Treas. Reg. § 1.61-21(g)(3)(iii).

[16] Treas. Reg. § 1.61-21(g)(3)(i).

[17] Treas. Reg. § 1.61-21(g)(7).

(a) 6,000 lbs. or less
(b) 6,001 lbs. to 10,000 lbs.
(c) 10,001 lbs. to 25,000 lbs.
(d) 25,000 lbs. or greater

All else being equal, the amount of income imputed will be greater for transportation provided a heavier weight class aircraft than would be the case for similar transportation provided on an aircraft in a lighter weight class.

(4) Determine Whether Employee is a Control Employee or a Non-Control Employee

Income is imputed at a higher level for certain employees defined by the Treasury Regulations as "Control Employees" than for other employees. "Control Employee" is defined with respect to a non-government employer as any employee who falls within one of the following four categories:

(a) All board- or shareholder-appointed, confirmed or elected officers of the employer; except that the regulation provides that this category will not exceed the lesser of ten employees, or 1% of all employees (rounded up to the nearest integer);

(b) The top 1 % of the most highly compensated employees of the employer (rounded up to the nearest integer); except that the regulation provides that this category will not exceed the top 50 most highly compensated employees;

(c) All persons who own 5 % or more of the equity, capital or profits interest in the employer; and

(d) All directors.[18]

(5) Determine Number of Persons with Respect to Whom Income is to be Imputed to the Employee

Unlike the Fair Market Valuation Rule (Wet Lease) pursuant to which the amount of income imputed to an employee is the same regardless of whether the employee traveled alone or with guests and /or family members, the SIFL method requires that income be imputed to the employee on a per-person basis if he or she is accompanied by family members and/or guests. Income imputed to an employee with respect to transportation provided to a guest or family member of the employee is calculated in the same manner as transportation provided to the employee. Thus, if transportation is provided to guest or family member of a Control Employee, income will be imputed to the Control Employee with respect to each guest or family member at the rate applicable to Control

[18] Treas. Reg. § 1.61-21(g)(8).

Employees.[19] Exceptions exist, however, for transportation provided to infants; the value of a flight on an employer-provided aircraft for transportation of any person who is less than two years of age is deemed to be zero.[20]

b. The Noncommercial Flight Valuation Formula

The Noncommercial Flight Valuation formula is deceptively simple to use. The amount of income to be imputed to an employee is calculated by multiplying the applicable SIFL cents-per-mile rate, by both the number of miles flown and by an *Aircraft Multiple*, and then by adding the applicable terminal charge. In some cases, however, it will be necessary to divide a single flight into up to three parts, and calculate each portion of the flight separately. This is because the applicable SIFL cents-per-mile rate changes after the first 500 miles of a flight, and again after the next 1,000 miles of a flight. In any case, however, only a single terminal charge will be added. Thus, for any flight over 500 miles, two or three separate calculations must be made, i.e., one calculation covering the first 500 miles of the flight, one calculation covering that portion of the flight that is in excess of 500 miles up to a total of 1,500, and, if applicable, one calculation covering that portion of the flight that is in excess of 1,500 miles. The products of each of the two or three calculations are added together, and then the terminal charge is added. If the employee is accompanied by family members or other guests, the amount derived from the foregoing calculation, including the terminal charge, is applied on a per-person basis.

(1) The Aircraft Multiple

The Aircraft Multiple is a function of two of the factors discussed above: the weight of the aircraft, and the employee's status as a Control Employee or Non-Control Employee. For each of the eight possible combinations of weight class and employee status, the Treasury Regulations prescribe an Aircraft Multiple that will act as a constant in the Noncommercial Flight Valuation formula. The function of the Aircraft Multiple is two-fold. First, to provide a greater valuation for any given flight in an aircraft in higher weight classes than for the same flight in a lower weight class aircraft. Second, to provide a greater valuation for any given flight provided to a Control Employee than for the same flight provided to a Non-Control Employee. The possible Aircraft Multiples are set forth in the following table:

---

[19] Treas. Reg. § 1.61-21(g)(7)(ii).

[20] Treas. Reg. § 1.61-21(g)(1).

Table 1.[21]

Weight Class	Aircraft Multiple Control Employee	 Non-Control Employee
6,000 lbs. or less	62.5%	15.6%
6,001 lbs. to 10,000 lbs.	125%	23.4%
10,001 lbs. to 25,000 lbs.	300%	31.3%
25,000 lbs. or greater	400%	31.3%

(2) The SIFL Rates

As previously stated, the Standard Industry Fare Level rates are published semiannually by the United States Department of Transportation. Following the publication of rates by the Department of Transportation, the IRS generally republishes the rates in a Rev. Rul. The rates applicable to flights conducted during the first six months of 2001 are set forth in the following table:

[21] Treas. Reg. § 1.61-21(g)(7)(i).

Table 2.[22]

Mileage Range	Amount Per-Mile
0 - 500 Miles	$ 0.1961
501 - 1,500 Miles	$ 0.1495
More than 1,500 Miles	$ 0.1437

Terminal Charge
$35.84

c. A Sample SIFL Calculation

The following example illustrates the steps required to calculate the amount to be imputed to an employee as income using the Noncommercial Flight Valuation Rule:

Example: Assume a Control Employee takes a two thousand three hundred statute mile flight on an employer-provided aircraft with a maximum certified takeoff weight of twenty thousand pounds (20,000 lbs.). Assume also that the flight is primarily for personal purposes and that the employee is accompanied by two personal guests, each of whom is at least two years of age.

Because the aircraft has a maximum certified takeoff weight of twenty thousand pounds (20,000 lbs.) and the employee is a Control Employee, the Aircraft Multiple (from Table 1, above) is 300%. In addition, because the flight is in excess of 1,500 statute miles, the flight must be divided into three segments for purposes of the Noncommercial Flight Valuation formula: one segment comprised of the first 500 miles of the flight; one segment comprised of the next 1,000 miles of the flight; and one segment comprised of the final 800 miles of the flight.

The amount of income to be imputed to the employee is calculated as follows:

(1) Calculate Value of First 500 Miles
500 x $0.1961[23] x 300% = $294.15

[22] Rev. Rul. 2000-13, 2000-12 I.R.B. 774.

[23] Value from Table 2 for 0 - 500 mile range.

(2) *Calculate Value of Next 1,000 Miles*
1,000 x $0.1495[24] x 300% = $448.50

(3) *Calculate Value of Remaining 800 Miles*

[24] Value from Table 2 for 501 to 1,500 mile range.

800 x $0.1437[25] x 300% = $344.88

(4) Add Products of Steps 1, 2, and 3, and Terminal Charge
$270.60 + $412.80 + $317.52 + $35.84[26] = $1,123.37

(5) Multiply Sum of Step 4 by Number of Persons (Employee and Guests) Flying
$1,123.37 x 3 = $3370.11

d. Combining Business and Personal Flights

Special rules apply in defining a flight for SIFL valuation purposes in situations in which a trip on an employer-provided aircraft serves both personal and business purposes, or includes separate personal and business flights. Where a flight is provided to an employee to a particular destination on an employer-provided aircraft, and the purpose of the employee in traveling to the destination serves both a personal and a business purpose, income must be imputed to the employee 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.[27] Factors to be considered in making such a determination include the amount of time spent on personal activities and the amount of time spent of business activities.[28]

In the context of a trip that includes two or more destinations other than the original point of departure, where at least one of the destinations is primarily for personal purposes, and at least one of the destinations is primarily for business purposes, income must be imputed to the employee with respect to the personal-purpose destinations. However, there are two different methods for defining the flight to be valued for imputed income purposes, and a determination as to which of the methods must be used requires a determination as to whether, under the principles described above, the trip as a whole was primarily for personal or business purposes.

(1) Trip Primarily Business

If the primary purpose of a trip that includes flights to both business and personal destinations is business-related, the amount of income that will be imputed to the employee will be the excess of the value of all the flights that comprise the entire trip, over the value of a hypothetical trip that included only the business destinations.[29] Consequently, the amount imputed to the

[25] Value from Table 2 for 1,501 or more mile range.

[26] Value from Table 2.

[27] Treas. Reg. § 1.162-2(b)(2).

[28] *Id.*

[29] Treas. Reg. § 1.61-21(g)(4)(ii).

employee in many cases will be less than the amount that would be imputed had the trip not included the business destination.

Example: An employee takes a trip from New York to Chicago, to Los Angeles, and back to New York. Assume that Los Angeles is a personal destination, Chicago is a business destination, and that the primary purpose of the trip is business.

The calculation of the value of the flight to be imputed to the employee is a three step process. The first step is to calculate the total value of all flights flown during the entire trip, i.e., the flights from New York to Chicago, from Chicago to Los Angeles, and from Los Angeles to New York, using the Noncommercial Flight Valuation formula. Assuming the SIFL values of such flights are respectively $1,500, $3,000, and $4,000, the total value of all flights in the itinerary as actually flown would be $8,500.

The second step is to calculate the total value of all flights that hypothetically would have been flown during the entire trip if the personal-purpose destinations had not been included in the itinerary. In this case, such a hypothetical trip would have included only flights from New York to Chicago, and a return flight from Chicago to New York. Assuming the SIFL values of such flights are $1,500 each, the total value of all flights in the hypothetical itinerary would be $3,000.

The third step is to subtract the value of the hypothetical trip in step two ($3,000) from the value of the trip actually flown as determined in step one ($8,500). The $5,500 difference is the amount imputed to the employee.

(2) Trip Primarily Personal

If the primary purpose of a trip that includes flights to both business and personal destinations is personal, the amount of income that will be imputed to the employee will be the total value of all flights that would have been flown during the entire trip if the business-purpose destinations had not been included in the itinerary.[30]

Example: Same facts as the prior example, except that the primary purpose of the trip is personal. The amount of income that will be imputed to the employee for the trip will be calculated based on a hypothetical trip that does not include a business stop in Chicago. In this case, such a hypothetical trip would have included only flights round-trip from New York to Los Angeles and back to New York.

[30] Treas. Reg. § 1.61-21(g)(4)(iii).

Assuming the SIFL values of such flights are $4,000 each direction, the total value of all flights in the hypothetical itinerary would be $8,000, which is the amount that is imputed to the employee as income.

e. Minimizing Imputed Income

Certain rules exist permitting a company to provide transportation to an employee for personal purposes while imputing income to the employee under the SIFL rules at a reduced rate, or not at all. One such exception is provided by the "Seating Capacity Rule," and another relates to "Bona Fide Security Concerns." Each is described below.

(1) Seating Capacity Rule

The seating capacity rule provides that if 50% or more of the regular passenger seating capacity of an aircraft is occupied by persons who are traveling primarily for the employer's business, the value of the flight for certain eligible individuals who are not traveling primarily for the employer's business is treated as zero, and the amount of imputed income is therefore zero.[31] Persons eligible for a zero valuation include employees, employees' spouses, dependent children and parents, all children under two years of age, retirees, and retirees' surviving spouses.[32] An employee may not realize a zero valuation for his or her non-eligible guests, but if the requirements of the seating capacity rule are otherwise satisfied, the valuation attributable to a non-eligible guest of an employee will be calculated as if the employee to whom the income will be imputed were not a Control Employee, even if the employee is in fact a Control Employee.[33] In determining whether this valuation rule is available, the 50% seating capacity requirements must be met both at the time the individual whose flight is being valued boards the aircraft, and when the individual disembarks from the aircraft.[34]

For purposes of the seating capacity rule, the seating capacity of the aircraft is the maximum number of seats that have at any time prior to the date of the flight been installed on the aircraft, even if some of the seats have been removed for the flight in question.[35] This would include seats that are occupied by flight crew who are not on such flight primarily to serve as flight crew. If a seat occupied by a member of the flight crew is not counted as a passenger seat, such member of the

---

[31] Treas. Reg. § 1.61-21(g)(12).

[32] Treas. Reg. § 1.61-21(g)(12)(i)(B)(1).

[33] *Id.*

[34] Treas. Reg. § 1.61-21(g)(12)(ii).

[35] Treas. Reg. § 1.61-21(g)(12)(iii).

flight crew is also disregarded in applying the 50% test.[36] The calculation does not, however, include seats that could not and have not at any time been legally used during take-off.

(2) Bona Fide Security Concerns and the Working Condition Safe Harbor

[36] Treas. Reg. § 1.61-21(g)(12)(v).

The amount of income imputed to an employee for personal flights may be reduced if the employer requires the employee to travel on an employer-provided aircraft for all flights, both business and personal, and if a bona fide business-related security justification for such requirement exists.[37] This special valuation rule is commonly referred to as the "Working Condition Safe Harbor". If the Working Condition Safe Harbor rule applies, the value of personal flights must be determined under the SIFL rules, even if the SIFL rules are not otherwise used or permitted, however, the SIFL rules are modified to provide that the aircraft multiple will not exceed 200% regardless of the weight of the aircraft.[38] The remainder of the calculation remains unchanged.

---

[37] Treas. Reg. § 1.132-5(m)(4).

[38] *Id*. The regulation provides that the excess of the value of the flight, however determined, over the value determined under the SIFL method using a 200% aircraft multiple, will be excluded from the employee's gross income as a working condition fringe benefit. In situations in which the value of the flight would in any event be equal to or less than the value determined under the SIFL method using a 200% aircraft multiple, there would be no excess value to exclude, and the regulation would have no practical effect. Examples of situations in which the value of the flight would in any event be equal to or less than the value determined under the SIFL method using a 200% aircraft multiple include the imputation of income under the SIFL method to Control Employee for use of an aircraft in a weight class of 10,000 lbs. or less, and the imputation of income under the SIFL method to a Non-Control Employee

Similarly, if a bona fide business-related security concern is determined to exist with respect to an employee, it is deemed to exist with respect to the employee's spouse as well, and as such, the aircraft multiple used in calculating the amount of income attributable to the employee's spouse likewise will not exceed 200% regardless of the weight of the aircraft.[39]

By specifying an aircraft multiple of 200%, the Working Condition Safe Harbor provides potential savings only to Control Employees obtaining transportation in aircraft that have maximum certified takeoff weights in excess of 10,000 lbs. as such employees would otherwise be subject to an aircraft multiple of 300%[40] or 400%,[41] and to any employee to whom income would otherwise be imputed using the Fair Market Valuation Rule (Wet Lease). The 200% aircraft multiple specified in the Working Condition Safe Harbor rule is higher than the aircraft multiple that would otherwise be applicable to Control Employees obtaining transportation in aircraft that have maximum certified takeoff weights of 10,000 lbs. or less, and to all non-Control Employees regardless of aircraft weight, and consequently the use of the Working Condition Safe Harbor rule would actually result in a greater amount of income being imputed to such employees were the rule to be used in such cases.

---

regardless of the weight class of the aircraft. In light of the foregoing, the practical effect of Treas. Reg. § 1.132-5(m)(4) is to cap the aircraft multiple at 200%.

[39] Treas. Reg. § 1.132-5(m)(4).

[40] Aircraft multiple generally applicable to Control Employees use of aircraft that have maximum certified takeoff weights in excess of 10,000 lbs., but not in excess of 25,000 lbs. Treas. Reg. § 1.61-21(g)(7).

[41] Aircraft multiple generally applicable to Control Employees use of aircraft that have maximum certified takeoff weights in excess of 25,000 lbs. *Id*.

In order for the Working Condition Safe Harbor valuation rule to apply, the employer must demonstrate that a specific bona fide business-related basis for concern exists regarding safety of the employee in question.[42] Such a demonstration requires a facts and circumstances-based analysis; a mere generalized concern for the safety and welfare of the employee is insufficient.[43] Types of concerns that would support the use of this valuation rule include threats of death or kidnapping; threats of serious bodily harm to the employee[44]; or a recent history of violent terrorist activity (such as bombings) in the geographic area in which the transportation is to be provided, unless such activity is focused on a group that does not include the employee.[45]

(a) An Overall Security Program

Even if an actual basis for concern exists, the general rule established by the Treasury Regulations provides that the IRS will consider it to be a *bona fide* security concern only if the employer establishes an overall security program acceptable to the IRS with respect to the employee.[46] Such a program must provide security to the employee on a 24 hour-a-day basis, including security at the employee's residence and workplace, and while traveling, whether for business or personal reasons.[47] In addition, the program must include the use of a bodyguard-chauffeur who is trained in evasive driving techniques, an automobile specially equipped for security, and guards, metal detectors, alarms, or similar methods of controlling access to the employee's workplace and residence.[48] An overall security program will be deemed to exist if it is established pursuant to an independent security study (discussed below).

(b) Alternative Security Program

In certain circumstances, the IRS will accept an alternative, less comprehensive security program in lieu of an overall security program for purposes of determining eligibility for the Working Condition Safe Harbor valuation rule.[49] In order to qualify an alternative security program, the security program must be established pursuant to the reasonable recommendations of an independent security consultant, and the consultant's recommendations must meet the following

---

[42] Treas. Reg. § 1.132-5(m)(2)(i).

[43] *Id.*

[44] Treas. Reg. § 1.132-5(m)(2)(i)(A).

[45] Treas. Reg. § 1.132-5(m)(2)(i)(B).

[46] Treas. Reg. § 1.132-5(m)(2)(B)(ii).

[47] Treas. Reg. § 1.132-5(m)(2)(B)(iii)(A).

[48] *Id.*

[49] Treas. Reg. § 1.132-5(m)(2)(B)(iv).

criteria:

i) The security consultant must perform, and base his or her recommendations on, a security study with respect to the employer and the employee.

ii) The security study must be based on an objective assessment of all the facts and circumstances relating to the threat against the employee.

iii) The security study must result in a reasonable determination that an overall (i.e., comprehensive) security program is not necessary under the circumstances.

iv) The recommendations of the security consultant must be applied on a consistent basis.

C. CONSISTENCY RULES

As has been shown above, the Noncommercial Flight Valuation Rule potentially could result in either a greater or lesser amount of income being imputed to an employee for personal flights than would be imputed to the employee under the Fair Market Valuation Rule (Wet Lease), depending on the number of guests and family members that accompany the employee, and the employees status as either a Control Employee or a Non-Control Employee. Consequently, there may be a desire on the part of some taxpayers to apply the Noncommercial Flight Valuation Rule to some flights, and the Fair Market Valuation Rule (Wet Lease) to other flights. Unfortunately, the Treasury Regulations prohibit such cherry-picking. As a general rule, in order to use the Noncommercial Flight Valuation Rule, it is necessary that both the employer and all the affected employees agree to apply the Noncommercial Flight Valuation Rule to all flights of all employees that are taken on employer-provided aircraft for the year.[50]

Two exceptions to the foregoing general rule apply. First, as discussed in IV.B.3.e.(2), above, the Noncommercial Flight Valuation Rule may be used to calculate the value of personal transportation provided to an employee on an employer-provided aircraft if the employee is required to use employer-provided transportation for personal flights as part of an overall or alternative security program, regardless of whether the Noncommercial Flight Valuation Rule is used to value personal transportation provided to other employees.

Second, certain errors on an original or amended tax return by either a Control Employee with respect to a particular flight, or by an employer with respect to a particular flight by a Control Employee, will result in the loss of the ability to use the Noncommercial Flight Valuation Rule to value the flight in question. Errors that will result in the loss of the ability to use the Noncommercial Flight Valuation Rule include imputing income at the Non-Control Employee rates, imputing income at the rates applicable to a lighter aircraft weight class than the class of the aircraft used, and excluding all or a portion of the value of the flight as a working condition fringe under I.R.C. § 132

[50] Treas. Reg. § 1.61-21(g)(14).

if it is subsequently determined that I.R.C. § 132 was not applicable to the flight in question.[51] Treasury Regulation 1.61-21(g)(13) appears to apply a strict liability standard with respect to the errors within its scope in that the regulations provides neither relief from its application in the event an error is inadvertent, nor relief to an innocent Control Employee in the event the error is caused by the employer.

[51] Treas. Reg. § 1.61-21(g)(13).

