

Strategies for Tracking & Reporting Non-Business Use of Aircraft

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Reimbursements for Expenses of Personal Flights under Part 91

- Generally Prohibited.
- Exceptions:
 - Dry Lease Structure
 - Time Sharing Agreements
 - Nichols Opinion



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.

Time Sharing Agreements

- FAR 91.501(c)(1): “an arrangement whereby a person leases his airplane with 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 typically retains operational control.
- Subject to federal excise taxes on commercial transportation.

Time Sharing Agreements

- 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

Nichols Opinion

- 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.
- In 1999, FAA Chief Counsel held in the “Schwab Opinion” that when an employee travels for personal purposes, the employee is a “guest” and the transportation is not within the scope of and incidental to the business of the company, and hence employee could not be charged for the flight.

Nichols Opinion

- In 2012 , the FAA Chief Counsel’s “Nichols Opinion” modified the “Schwab Opinion” to permit charging a pro-rata share of the costs of owning, operating and maintaining the aircraft, for certain employees whose position with the company merits a high level of company interference into the employees’ personal travel plans (e.g., senior executive who may need to be recalled early from vacation).
- Company retains operational control.
- Subject to federal excise taxes on commercial transportation.
- Company must create and update a list of individuals whose position with the company require him or her to routinely change travel plans quickly.

IRC § 274

- Section 274 of the tax code limits deductions for expenses of facilities (including aircraft) used for entertainment, amusement or recreational purposes.
- A business aircraft is considered to be such a facility.
- Expenses for entertainment, amusement, and recreational flights of “Specified Individuals” are deductible only UP TO the amount of income imputed to (or reimbursement received from) the Specified Individuals. All other expenses are disallowed.

Who is a Specified Individual?

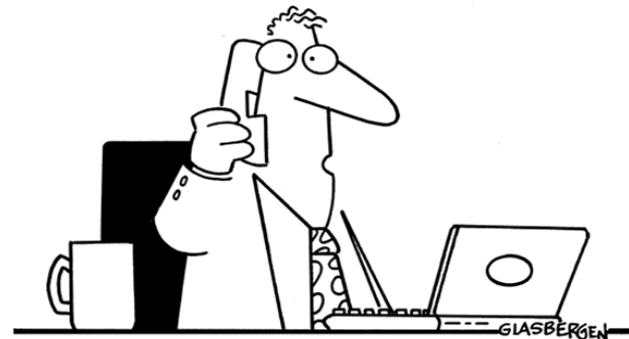
- The term “Specified Individuals” includes all officers, directors and persons directly or indirectly owning more than 10% of any equity class of the taxpayer, or any related party (within the meaning of IRC §§ 267(b) or 707(b)).
 - Includes spouse, family members or guests of the specified individual.



What is Entertainment?

- Personal Entertainment Includes:
 - Sports events
 - Hunting
 - Fishing
 - Golfing
 - Travel to Country Clubs
 - Skiing
 - Resort Destinations

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“If my company is going downhill fast, can I take a ski vacation and write it off as a business expense?”

What is Entertainment?

- Personal, but Probably NOT Entertainment Includes:

- Commuting
- Travel to a funeral
- Travel to for medical purposes
- Travel for charity work
- Travel for business other than that of the employer providing the flight
- Travel to meetings with personal advisors
- Transportation between homes not associated with entertainment



Mixing Business and Recreational Activities

- Regulations under 274 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.



Mixing Business and Recreational Activities

- 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 (“Predominant Use test”).
- In light of the absence of guidance in the regulations under 274, it should be reasonable to assume that a similar Predominant Use test may be used for 274 purposes.

Mixing Business and Recreational Activities

- When a flight includes multiple destinations, at least one of which is for business purposes, and at least one of which is 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.



What Expenses are Subject to Disallowance?

- Taxpayers must include all expenses of operating and maintaining the aircraft during the taxable year, including, for example:
 - Fuel
 - Landing fees
 - Overnight hangar fees
 - Catering
 - Meal and lodging expenses of the flight crew
 - Management fees
 - Hangar rent
 - Salaries of pilots
 - Maintenance personnel and other personnel assigned to the aircraft maintenance costs
 - Lease payments (if aircraft is leased rather than owned)
 - Charter fees (if aircraft is chartered rather than owned)
 - Tax depreciation*
 - Interest traceable to aircraft purchase

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 MACRS is used for tax 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.

Special Rules Regarding Depreciation Expense

- Regulations also clarify that where a taxpayer elects to use ADS for purposes of calculating the disallowance attributable to entertainment flights, the amount disallowed in any given year as a result of the election to utilize ADS may not exceed the amount of depreciation otherwise allowable for that tax year.
- This may result in less than 100% of the basis in the aircraft being subject to disallowance over time.



Methodologies for Calculating Disallowance of Aircraft Expense Deductions

- 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

Record Keeping and 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 3 buckets: business non-entertainment, entertainment or personal non-entertainment.

Business Non-Entertainment



Entertainment



Personal Non-Entertainment



Record Keeping and 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 3 buckets.
- The average cost per occupied seat mile (or hour) for the taxable year is determined.

Allocating Expenses to Business and 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.



Allocating Expenses to Business and 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.



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