‘Tis the Season for Giving: Maximizing Your Aircraft Charitable Deductions

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Many companies have excess capacity with their corporate aircraft and generously allow their employees the use of the aircraft for charitable purposes. However, most companies are unaware that there is a way to maximize the permitted tax deduction beyond the limits of the charitable restrictions offered by the IRS.

The following is a hypothetical example of a conversation between the Chief Executive Officer (Mr. Jones) and the Chief Financial Officer (Mr. Smith) of a corporation on a Friday.

Mr. Jones: Mr. Smith, I need to speak with you about the corporate aircraft.

Mr. Smith: Sure, what's going on?

Mr. Jones: This past year we have not used the aircraft nearly as much as we thought we would, so I want to begin to allow our employees to use the aircraft for charitable purposes.

Mr. Smith: That is a good idea.

Mr. Jones: What is the financial impact to the company of allowing our employees to use the aircraft for charitable purposes?

Mr. Smith: Well, we would receive a tax deduction but I believe it would be limited to the variable expenses.

Mr. Jones: So, we could not deduct all those fixed costs, including the tax depreciation?

Mr. Smith: Unfortunately, but I can find out if there is another way.

Mr. Jones: Please find out in time for Monday's meeting.

(An awkward pause.)

Mr. Smith: ...I will have something for Monday.

Mr. Smith spends the entire weekend researching and talking on the phone with an aviation tax attorney. In Monday's meeting he presents:

Mr. Smith: Mr. Jones would like to allow our employees to use the aircraft for charitable purposes and asked that I assess the potential financial impact to the company of doing so. Businesses are allowed a deduction for all the ordinary and necessary business expenses under Code § 162 while the availability of and limits on charitable deductions are set forth in Code § 170. Unfortunately, the amount of the aircraft charitable deduction is limited to “out-of-pocket expenses.” This limits aircraft deductions to the variable expenses of operating the aircraft namely: the cost of fuel, oil, and any pilot fees for that specific flight. Therefore, the company will lose the ability to deduct the largest portion of the costs of the aircraft, the fixed expenses and tax depreciation. As an example, if the total flight hours of
the aircraft in a given year are allocated 75% for business use and 25% for charity use, we would lose 25% of the aircraft’s fixed expenses and tax depreciation. Losing those deductions would cost the company millions.

Mr. Jones: Were you able to find any other alternatives?

Mr. Smith: I believe I did. For IRS purposes there are three categories of flights: business, personal non-entertainment, and personal entertainment. In our company most of our flights are for business purposes and therefore easy to classify. However, whether a flight is for a personal non-entertainment or personal entertainment purpose is often difficult to ascertain. In making such a distinction, it appears that, personal entertainment flights are simply flights where the primary purpose of the trip is fun. Examples of these flights include: hunting trips, vacations, golf and ski trips, and trips to sporting events. Conversely, certain flights are personal in nature but are not necessarily entertainment. Some examples of these flights include: medical trips, funerals, trips for non-company business such as participation in other boards, and commuting to the office.

Mr. Jones: So, into which category does a charity flight fit?

Mr. Smith: Well, classifying a charity flight as a business flight would only be possible if the company itself were able to treat the flight as a goodwill advertising expense. However, employees using the aircraft for charitable purposes should be able to treat the charity flight as a personal non-entertainment flight. While, there is a lack of guidance specifically on point regarding the issue of whether a charitable flight can be treated as a flight falling into personal non-entertainment category we know that it is not a personal entertainment flight. The IRS released Proposed Regulations this summer regarding the personal use of aircraft and the preamble of those regulations explained that charity flights are not entertainment flights and not subject to the disallowance rules pertaining to those types of flights.

Mr. Jones: Well, then it must be fine to categorize charity flights as personal non-entertainment, correct? What are the tax ramifications of personal non-entertainment flights?

Mr. Smith: Hold on. The Preamble simply explains that charity flights are not entertainment flights. It does not provide a statutory alternative to the Regulations under Code § 170. However, if the flights could be categorized as being undertaken for a personal non-entertainment purpose, the company could preserve the deductibility of both the fixed and variable expenses of the aircraft by imputing the value of the flight into the income of the person sponsoring the flight, similar to any other fringe benefit.

Mr. Jones: How do you impute the value of the flight?

Mr. Smith: The best way is to use the IRS’s “SIFL” formula.

Mr. Jones: What exactly is SIFL?

Mr. Smith: SIFL is short for Standard Industry Fare Level. It is used in an IRS formula for imputing income for aircraft transportation services provided to an employee that is based upon the size of the aircraft, the distance traveled, the number of passengers on board, and a multiple that is higher or lower depending on whether the employee responsible for the flight is a “control” employee or a “non-control” employee. The valuation is roughly equivalent to
the cost of a first-class ticket if you are a control employee.

Mr. Jones: It sounds like the personal non-entertainment classification is the way to go. Is there any precedent for treating charitable contributions as SIFL flights?

Mr. Smith: Actually (flipping through his notes), there is. All of the changes regarding the personal use of aircraft stem from a court case called Sutherland Lumber- Southwest, Inc v. Commissioner, where the court upheld the use by business aircraft owners of the SIFL method for both personal non-entertainment and personal entertainment flights. The owner in that case had “nonvacation” flights, some of which were charity flights. The court upheld the use of the SIFL method in connection with the charity flights.

Mr. Jones: Good enough. Are you prepared to handle everything necessary to put this in place? If the IRS audits the company I do not want to lose. I would assume that the documentation requirements to implement this and all other flights are quite extensive.

Mr. Smith: I am not sure exactly what we preparations we need to make to be sure we would win an IRS audit.

Mr. Jones: It sounds like we had better call your aviation tax attorney.

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