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NBAA

NBAA PERSONAL USE OF BUSINESS AIRCRAFT HANDBOOK

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This NBAA publication is intended to provide Members with an introduction to the tax rules and other regulations that relate to the topic of personal use of business aircraft. Readers are cautioned that this publication is not intended to provide more than an illustrative introduction to the subject matter, and since the materials are necessarily general in nature, they are no substitute for the advice of legal and tax advisors addressing a specific set of facts that readers may face. Additionally, this version of the handbook is dated May 22, 2009, and does not incorporate any statutes, regulations or guidance released after that date.

Overview

The *NBAA Personal Use of Business Aircraft Handbook (Personal Use Handbook)* summarizes the tax rules for companies to calculate the amount of the taxable fringe benefit to report to their employees, directors and independent contractors who use the company's aircraft for personal purposes. In Section III, it summarizes the tax rules governing the calculation of a company's nondeductible expenses under the entertainment disallowance as amended by the American Jobs Creation Act of 2004. The *Personal Use Handbook* emphasizes the importance of detailed records to substantiate the business purposes of the business flights as well as the nonentertainment purposes of personal nonentertainment flights. The appendices provide sample calculations and a table of illustrative examples covering common scenarios.

I. FAA Regulatory Considerations

As background, the following is a general description of the Federal Aviation Administration (FAA) regulatory considerations with respect to personal flights. A complete explanation of the Federal Aviation Regulations (FARs) in Title 14 of the Code of Federal Regulations is beyond the scope of the *Personal Use Handbook*.

Aircraft operators may obtain certificates to operate aircraft under various parts of the FARs. To conduct charter flights, the operator generally must obtain a certificate to operate under FAR Part 135, which allows the aircraft operator to receive payment for conducting charter flights. If no operating certificate is obtained from the FAA, the aircraft operations are governed by the general aviation provisions in FAR Part 91. Subject to certain exceptions, Part 91 generally forbids the operator to receive payment for providing air transportation service.

A company can operate an aircraft under Part 91 to transport passengers as long as the transportation is within the scope of the company's business, and transportation by air is not the primary purpose of the business.[1] Such flights can only be provided to the company's parent company, subsidiary company or a subsidiary of the company's parent company. The company may accept reimbursement from these companies for the cost of owning, operating and maintaining the airplane for such flights. The prohibition in Part 91 on providing air transportation for compensation or hire generally permits a company to provide flights to its employees and others for their personal purposes as long as no payment is accepted for such flights. A company is not permitted to receive cash payments from its employees for personal flights provided by the company.[2]

However, a company can provide flights under FAR Part 91 under a time-sharing agreement, which permits the company to accept reimbursement up to a maximum of twice the fuel cost plus certain enumerated expenses.[3] If the aircraft's maximum certified takeoff weight is less than 12,500 lbs., the company must be a member of NBAA and follow certain additional procedures to conduct flights for which payment is accepted under a time-sharing agreement. FAR Part 91 also permits a company to lease an aircraft without providing pilot services (a "dry lease") and to own and operate an aircraft with others under a joint ownership arrangement as defined in the FARs.

Notwithstanding these exceptions to the general rule that an aircraft operator cannot accept payment for transportation by air conducted under Part 91, an aircraft operator that does not have a Part 135 certificate (or other FAA operating certificate) is not permitted to operate as a "flight department company."[4] In general, a flight department company is a company that operates an aircraft, when such operations are the primary purpose for the company's existence. The FARs require that flights conducted by a company operating under Part 91 be "incidental" to another business of the company. In contrast, a company can operate an aircraft as its only activity under a Part 135 certificate.

An individual can operate an aircraft under Part 91 to transport such an individual in connection with either business or personal activities. However, there is some risk that Part 91 would not permit an individual to operate an aircraft in connection with his or her business activities and accept reimbursement for such flights, such as reimbursement from the individual's employer. An exception applicable to owner-pilots may permit such a reimbursement to an owner-pilot if he or she is the only person on board the aircraft.[5]

II. Imputed Income for Personal Flights

A. GENERAL OVERVIEW OF IMPUTED INCOME RULES FOR PERSONAL FLIGHTS

The amount includable in the employee's income for personal use of an employer-provided aircraft will be based on either the fair market value of the transportation (at fair market charter rates) or the Standard Industry Fare Level

(SIFL) rates. Under either method, the amount of imputed income to the employee with respect to any personal flight is reduced by any reimbursement received by the employer for the flight.[6]

The income reporting rules discussed in this section and the deduction disallowance rules discussed in Section III operate independently of each other. An amount cannot be excluded from an employee's income simply because the employer is willing to forego a deduction for such amounts.

B. AIRCRAFT ARRANGEMENTS SUBJECT TO IMPUTED INCOME RULES

1. Personal Flights Provided to Service Providers – Referred to as "Employees"

The imputed income rules apply to flights provided in connection with the performance of services.[7] These rules apply even when the person providing the services is not a common law employee. For convenience, the imputed income rules use the term "employee" to include all such service providers including partners, directors and independent contractors.[8] The rules also apply to flights provided to former employees.[9] Accordingly, the term "employee" is used in this *Personal Use Handbook* to refer to this expanded definition of employee.

2. Guests of Employees

When personal guests or family members of an employee are on board, the employee – not the guest – is considered to have received the fringe benefit for tax purposes.[10] Therefore, the value of a flight provided to an employee's personal guest is included in the imputed income reported to the employee, at the rate applicable according to the employee's status. However, the value of a flight for a passenger less than two years old is always zero.[11]

3. Identification of "Employer"

The "employer" for purposes of these rules is the employer for whom the employee performs the services in return for which the fringe benefit flight is provided.[12] Therefore, when an employee performs services for Company A and a flight is provided to the employee by Company B as compensation for the employee's services to Company A, the fringe benefit would ordinarily be reported to the employee by Company A.

4. Sole Proprietors

The imputed income rules generally do not apply to an individual's personal use of his own aircraft, because such an aircraft is not employer-provided. For example, when an individual operates an aircraft in the individual's sole proprietorship business, the individual's personal flights on that aircraft would not constitute employer-provided flights and would not be subject to the imputed income rules. Instead, the sole proprietor would not be entitled to deduct the costs attributed to the personal flights, as explained below in Section III.A (Sole Proprietors). Sole proprietorships generally include businesses operated directly by the individual as well as businesses operated in a disregarded entity owned by the individual, such as a single-member limited liability company.

5. Flights Not Provided as Compensation; Excessive Compensation

The Treasury Regulations governing the valuation of employer-provided flights (including the SIFL rules) apply to flights provided in connection with the performance of services.[13] Accordingly, when the individual receiving the flight did not perform any services, and is not the guest of an employee, the regulations governing employer-provided flights (including the SIFL rules) may not be applicable.

When a noncompensatory flight is provided by the company for company business reasons, such as to an employee of another company on a flight to inspect company property in connection with the negotiation of a sale of the property, no imputed income would be required.[14] Moreover, when a flight is provided to a nonguest individual for the individual's personal travel, the noncompensatory flight likewise would not appear to be governed by the fringe benefit regulations in Treas. Reg. § 1.61-21. The result may be that the SIFL rules discussed below in Section II.E (SIFL Rate Method) are unavailable to calculate the value of personal flights provided to an individual such as a stockholder who performs no services and is not the guest of an employee.[15] Whether the value of such flights must be reported on Form 1099 is unclear and may depend on the circumstances.[16]

Similarly, when the value of flights provided to an employee would constitute excessive compensation with respect to the services performed, the result may be that the SIFL rules are not applicable. The tax treatment of such flights (e.g., as dividends in the case of a stockholder) will depend on the relevant circumstances.[17]

6. Employer-Provided Aircraft *Without* Pilot

The imputed income rules generally will apply to employer-provided personal flights, irrespective of the means by which the employer obtains the use of the aircraft. It does not matter whether the aircraft is wholly-owned, owned as a fractional interest, leased or chartered by the employer. However, when the employer provides the use of an aircraft without pilot, only the fair rental value of the aircraft is imputed to the employee.[18] Nevertheless, the Treasury Regulations do not appear to preclude the use of the SIFL valuation rules for such flights.

C. DISTINGUISHING PERSONAL FLIGHTS FROM BUSINESS FLIGHTS

1. General Rules

In general, the value of an employer-provided flight for the employee's personal purposes must be imputed to the employee. In the case of a sole proprietor, the costs attributable to personal flights of the sole proprietor may not be deducted, as explained below in Section III.A (Sole Proprietors).

No imputed income is required for an employer-provided flight for the employer's business purposes. Such flights are excludible from the employee's income as a "working condition fringe."[19] A working condition fringe benefit is any property or service provided by an employer to an employee to the extent that the property or service would have been deductible by the employee as an ordinary and necessary business expense if the employee had paid the expense.[20] Therefore, to be excludible as a working condition fringe, a business flight must satisfy the ordinary and necessary business expense requirement under IRC § 162(a) and not be subject to the entertainment disallowance under IRC § 274(a). The same two requirements must be met for a sole proprietor to deduct the costs attributable to a flight.

Since imputed income applies to each passenger traveling for personal purposes, the business or personal character of a flight must be determined separately for each passenger.[21]

a. Ordinary and Necessary Business Expenses

The ordinary and necessary business expense standard requires that the expense be "appropriate" and "helpful" in carrying on the taxpayer's business, that it be a common and accepted practice, and that it be reasonable in amount.[22] The requirement that the use of a private aircraft be a common and accepted practice is easily met since the courts have recognized that it is common practice for an executive in charge of a large project to use a private aircraft for transportation.[23]

(1) Reasonableness of Use of Private Aircraft

To establish that the use of private aircraft is reasonable in amount, it is often helpful to show that the private aircraft saves time for the passengers and enables the passengers to attend more meetings and otherwise be more productive than they would be traveling on commercial airlines.[24] There are of course other facts that may support the conclusion that the use of a private aircraft is ordinary and necessary, such as the additional security benefit, ability to discuss confidential business while traveling, access to more remote airports and flexibility in scheduling.

In assessing the reasonableness of the use of a private aircraft, courts compare the costs of operating the aircraft with the revenue derived from the business activity.[25] In making this comparison, the costs of operating the aircraft should not include depreciation expense.[26]

Companies using private aircraft for business purposes may want to identify these advantages in an aircraft use policy approved by their board of directors. It also may be useful to document the increased productivity and other benefits to the company through internal studies or with the assistance of outside consultants.

(2) Business Purpose Is Based on Primary Purpose of Flight

When a flight is partly for business purposes and partly for personal purposes, its classification as a business flight or a personal flight is determined based on the *primary* purpose for the trip.[27] There is no bright line test as to how much business and how much personal activity must occur for a trip to be classified as primarily for business. It is a facts and circumstances determination.[28] Courts look to the proximate relationship between the business activity and the transportation costs incurred.[29]

(3) Examples of Business Travel

Travel to meet with customers, suppliers and other business associates will typically be respected as ordinary business travel.[30] Travel in connection with a taxpayer's farming activity conducted for profit also can meet the ordinary and necessary business expense requirement.[31] In addition, travel in connection with management services provided for a fee by one company to a commonly owned company can meet the ordinary and necessary business expense test.[32]

Travel to meet at a vacation location can be business, if there are sufficient business discussions.[33] However, to be deductible, such travel that involves entertainment must meet the "directly related" or "associated with" business tests described below in Section II.C.1.b (Business Entertainment). In fact, entertaining employees of a company's customers may meet the § 162 ordinary and necessary business expense test but nevertheless be nondeductible under the entertainment disallowance in § 274(a) because it fails to meet the "directly related" or "associated with" tests.[34]

The ordinary and necessary business expense test can be met through meetings with other business people and service on the board of directors of a charitable organization for networking purposes or to compare views on matters such as trade or economics that are important to the company's business.[35] In addition, expenditures for institutional or "good will" advertising are ordinary and necessary business expenses if the expenditures are related to the business that the company reasonably expects to receive in the future.[36] For example, in *Leo A. Daly Co. v. Vinal*, 23 A.F.T.R.2d 69-843 (D. Neb. 1968), expenses of an architect's service on the board of a civic organization were found to be deductible business expenses as a form of institutional advertising. However, in another case, a court held that an individual's service on the board of a college served no business purpose.[37]

The deductibility of an employee's attendance at conventions and other meetings depends on whether there is a sufficient relationship with the employer's trade or business.[38] When the convention or seminar program includes subjects designed to make those present more effective in their business activities, it would ordinarily be deductible.[39] In *Manning v. Commissioner*, T.C. Memo (RIA) 1993-127, a radiologist's travel to meetings directly related to his work was treated as business (International Congress of Radiology, CT meetings, Pennsylvania Radiology Society, radiology meeting at Harvard), but other meetings were not business when they bore a weaker relationship to business and in-

volved more personal activities.[40] Likewise in another case, general business seminars not related to particular business matters relevant to the attendees did not meet the ordinary and necessary business expense test.[41]

Note that it is only necessary to consider whether the "directly related" or "associated with" business tests described below in Section II.C.1.b (Business Entertainment) are met, if entertainment activities are involved.

(4) Examples of Personal Travel

In contrast, a trip undertaken primarily for personal purposes is not treated as business based only on some incidental business activity on the trip, as shown in the following examples. A trip to the Superbowl was primarily for personal purposes in view of the relatively insignificant amount of business conducted.[42] Travel to a passenger's rental property primarily to engage in personal activities was not converted to business travel merely because the passenger observed some repairs that needed to be made on the rental property.[43] Similarly, the wedding of a family member was not treated as business based on business connections with guests attending the wedding.[44] Travel on a honeymoon was held to be personal travel, even though the taxpayer, a professional sports writer, did some research on Roberto Clemente's background while on the trip.[45]

As explained above, travel to a vacation location for a business meeting can qualify as business travel. However, travel to a vacation home simply to have a more relaxed place to work would ordinarily be regarded as personal. In *Beckley v. Commissioner,* T.C. Memo (RIA) 1975-37, the individual worked as a writer at his vacation home. However, there was no sufficient business reason for traveling to the vacation home to do the writing, when it could be done at the taxpayer's home or regular place of business.

(5) Commuting Versus Business Travel

Business travel generally does not include commuting from the employee's residence to the employee's principal place of business.[46] Flights for business purposes from the employee's residence to destinations other than the location of the principal place of work generally would be business travel.[47] Sometimes an employee resides near a secondary place of business (i.e., not the employee's principal place of business). In that case, a flight from the principal place of business to the secondary place of business would generally be business travel if there was a business purpose for traveling to the minor place of business.[48] The fact that the employee remains at the location of the minor place of business to go to his or her residence should not cause the flight to be commuting.

(6) Important Factors to Support Business Travel

The most important consideration under the ordinary and necessary business expense test is whether the business conducted on the trip actually constitutes the primary purpose for the trip. However, there are several factors that can be important in making this determination.

(i) Relative Time on Business and Personal Activities

In determining whether a trip is primarily for business or personal purposes, the relative amounts of time spent on business and personal activities is an important factor, although it is not determinative.[49] As an example, the Treasury Regulation states that when an individual travels to a destination to spend one week on business matters and five weeks on personal matters, the trip will be treated as primarily personal in nature in the absence of a clear showing to the contrary. In one case, a trip to a vacation location was treated as primarily personal when the passenger's purported business purpose for the trip was that he spoke to a few people about the idea of investing in a bank.[50] In another case, the court treated a trip to a trade association meeting for three days as primarily personal when the rest of the time on the passenger's 15-day trip was for personal purposes.[51] In *Manning v. Commissioner,* T.C. Memo (RIA) 1993-127, the court considered the relative numbers of days of business and personal activities in holding that several trips were nondeductible (two-day meeting during two-week trip; three-hour meeting during one-week trip).

(ii) Existence of an Agenda

In stating generally that travel to attend a convention should qualify as business travel, the IRS emphasizes the importance of an agenda as evidence that the convention is related to the employee's work.[52] Furthermore, an agenda that includes subjects designed to make those present more effective in their business activities and that indicates careful and extensive planning preceded each meeting is helpful in establishing business purpose.[53] In *Manning*, the court pointed to the absence of an agenda or syllabus as a reason for the disallowance of travel expenses with respect to meetings.

(iii) Location of the Conference Site

The location of the purported business activity may be an important factor. The fact that a convention is held at a resort hotel is a consideration (but is not dispositive) in determining the primary purpose of a trip.[54]

(iv) The Company's Characterization of the Trip

Although not determinative, the company's characterization of a trip as a morale builder or as a vacation can negatively impact whether the trip is deemed primarily for business or primarily for pleasure.[55]

(v) The Presence of a Spouse or Guest

In *Ireland v. Commissioner,* 89 T.C. 978 (1987), the presence of family members on trips to a vacation property was considered by the court in concluding that the trips were for entertainment purposes. In *Cowing v. Commissioner,* T.C. Memo (RIA) 1969-135, the presence of the doctor's wife was considered by the court in its determination that several trips were primarily for personal purposes.

b. Business Entertainment

When a passenger's primary activity at a destination is an entertainment activity, additional requirements under the

entertainment disallowance in § 274(a) must be met for the trip to be deductible as a business expense. The alternative of deducting travel expenses as the cost of providing a fringe benefit is discussed below in Section III (Entertainment Deduction Disallowance). The expenses for entertainment are not deductible as business expenses unless the entertainment activity was "directly related" to the active conduct of business, or it was "associated with" the active conduct of business and occurred directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise).[56] Entertainment activities meeting either the "directly related" or "associated with" tests are referred to as "business entertainment."[57]

(1) Definition of Entertainment

Entertainment is generally defined as "any activity which is of a type generally considered to constitute entertainment, amusement, or recreation."[58] It is further defined by the examples of "entertaining at night clubs, cocktail lounges, theaters, country clubs, golf and athletic clubs, sporting events, and on hunting, fishing, vacation and similar trips." Activities identified as entertainment by the courts include sailing, sightseeing, parties and luncheons at the Kentucky Derby, attending the Superbowl, staying at beachfront property and parties at the taxpayer's home.[59]

Entertainment is determined on an objective basis.[60] An activity generally considered to be entertainment will be treated as entertainment for tax purposes, irrespective of whether the taxpayer actually enjoyed the activity. For example, in *Walliser*, the taxpayer's sightseeing tour with customers constituted entertainment, even though it was so strenuous for the taxpayers that they did not enjoy it.

In determining whether an activity is entertainment, the taxpayer's trade or business is taken into consideration.[61] For example, a trip to the theater would not be classified as entertainment for a theater critic attending the show in that capacity, and a fashion show would not be classified as entertainment for a clothing manufacturer showing clothing to store buyers.

(2) "Directly Related" to Business Requirement

Under the "directly related" test, there must be substantial business discussions at the entertainment event. In light of all the facts and circumstances, the "principal character" of the combined business and entertainment must be the active conduct of the taxpayer's business.[62] If the purpose of the entertainment is to create goodwill with only a general expectation of deriving income or other business benefit in the future, the "directly related" test is not met. Stated otherwise, the "directly related" test is not met if the entertainment is only vaguely or remotely connected with business.[63]

In *Townsend Industries, Inc. v. United States*, 342 F.3d 890 (8th Cir. 2003), a company's fishing vacation for employees met the directly related test, because on the trip the company announced the launch of a new product, and the employees discussed the complexity and problems with customers, employees, salespeople and products, as well as sales tactics and client-specific issues. In *Churchill Downs, Inc. v. Commissioner,* 307 F.3d 423 (6th Cir. 2002), the IRS agreed that a gala, brunch, hospitality tent and parties were entertainment that was directly related to Churchill Downs' business of operating a horse race. In *United Title Insurance Co. v. Commissioner,* T.C. Memo (RIA) 1988-38, the company's out-of-town meetings with real estate professionals met the directly related test, because the meetings were formal pre-arranged business meetings in which the company discussed substantive business matters with the real estate professionals and obtained input from the professionals on a variety of topics. In *Custis v. Commissioner,* T.C. Memo (RIA) 1982-296, the court found that an insurance salesman met the directly related test when he brought potential customers to his hunting lodge for the weekend, based on his discussion of insurance products with the potential customers.

However, in numerous other cases, the courts found that the taxpayers did not meet the directly related test, because the evidence presented did not establish that their business discussions rose above the level of merely promoting goodwill.[64] Under several of these cases, the entertainment activity enhanced goodwill, thereby meeting the ordinary and necessary business expense test under § 162, but failed to constitute the active conduct of business, thereby failing to meet the directly related to business standard.

(3) Clear Business Setting; Entertainment Presumptions

Entertainment occurring in a "clear business setting" is deemed to meet the directly related to business requirement.[65] A clear business setting is one in which the recipient of the entertainment would have reasonably known that the company had no significant motive, in incurring the expenditure, other than directly furthering its business. An example includes a hospitality room at a convention. In addition, entertainment in a clear business setting may occur when there is no "meaningful personal or social relationship" between the taxpayer and the recipients of the entertainment. An example would be the opening of a new hotel or theatrical production where the purpose is to obtain business publicity, rather than to maintain or create the goodwill of the recipients of the entertainment.

In contrast, it is presumed that entertainment will not be directly related to business when it occurs on hunting or fishing trips or on pleasure boats.[66] In addition, it is presumed that the directly related to business standard is not met when the entertainment occurs in circumstances in which there is little or no possibility of engaging in the active conduct of business.[67] Examples of such circumstances include night clubs, theaters, sporting events and parties. Such circumstances also include meeting with persons other than business associates at cocktail lounges, country clubs, golf and athletic clubs or vacation resorts. Both of the presump-

tions may be rebutted by a clear showing that the taxpayer in fact engaged in the active conduct of business.

For example, in *Townsend*, the court found that the evidence presented by the company regarding the extent of the business discussed on the fishing vacation was sufficient to overcome the presumption. However, in *Danville Plywood*, the court noted the festival atmosphere at the Superbowl and decided that the taxpayer had not presented sufficient evidence of business meetings to overcome the presumption.

(4) "Associated With" Business Alternative

As an alternative to the "directly related" to business test, a company can qualify its entertainment activity by meeting the "associated with" business test. Under this test, the entertainment activity must be "associated with" the active conduct of business and it must occur directly preceding or following a "substantial and bona fide business discussion."[68] Associated entertainment must have a clear business purpose such as to obtain new business or encourage the continuation of existing business. In general, promoting goodwill with business associates would appear to satisfy this "associated with" standard.

A "substantial and bona fide business discussion" is one in which there is a substantial business meeting, negotiation, discussion or other bona fide transaction for the purpose of obtaining income or other specific business benefit.[69] This requires that the principal character of a combined business and entertainment activity be the active conduct of business. A scheduled program at a convention generally will be considered a substantial business meeting if it meets the ordinary and necessary business expense requirement under § 162 and the scheduled program of meetings and presentations are the principal activity of the convention. Presumably, the associated with business test would be met by the conventions in *Peoples Life* and *Acacia* discussed above in Section II.C.1.a(3) (Examples of Business Travel).

To meet the requirement that the associated entertainment occur directly preceding or following the substantial business discussion, the entertainment generally must occur on the same day as the business entertainment.[70] However, the regulations also would include entertainment occurring in the evening before a substantial business discussion. For example, taking a business associate from out-of-town to dinner on the evening of his or her arrival prior to meetings the next day would satisfy the directly preceding requirement.

2. Spouse, Family and Personal Guests

a. Classification of Flights by Spouse, Family and Personal Guests

As a practical matter, an employee's spouse, family and personal guests almost always travel for personal purposes, rather than ordinary and necessary business purposes under § 162. Therefore, it is usually necessary to impute income to the employee for their flights.

The Treasury Regulations provide that a spouse and other family members traveling with an employee will only meet the ordinary and necessary business expense requirement if their presence serves a bona fide business purpose.[71] Performing some incidental service is not sufficient. The courts have held that meeting and socializing and serving as a host or hostess is not sufficient to meet this standard.[72]

Services by a spouse that did *not* constitute bona fide business purposes include:

- Attending business lunches and dinners
- Staffing a convention hospitality suite
- Hosting dances and receptions
- Typing notes[73]

The mere expectation alone that spouses are to attend a function that requires travel on the business aircraft does not necessarily meet the requirements to consider the spouse's travel an ordinary and necessary business expense. However, a spouse's presence has been found to constitute a bona fide business purpose in the following circumstances:

- Not only entertaining but also helping a spouse understand a foreign language
- Performing clerical functions, entertaining and touring plants (but not sightseeing)
- In rare cases, attending and helping entertain at various events (luncheons, screenings, meetings) where other spouses are present and company policy requires employees to be accompanied by their spouses when traveling to project a family-friendly image
- Acting as business manager and road manager
- Acting as chaperone for minor contestants
- Attending business seminars directed to spouses of salespeople[74]

If an accompanying spouse's business-related activities are sufficient to support an ordinary and necessary business expense deduction under the above cases, it would still be necessary to determine whether the entertainment disallowance would apply. Accordingly, if the spouse's primary activity consists of engaging in entertainment activities (e.g., attending social functions), the "directly related" or "associated with" tests described above in Section II.C.1.b (Business Entertainment) would need to be considered.

b. Travel Deduction Limitation Under § 274(m)(3) on Spouses, Dependents and Personal Guests

IRC § 274(m)(3) purports to limit a company's deduction with respect to spouses, dependents and personal guests accompanying employees on business travel. However, this rule has little or no effect on most companies due to restrictions on its application.

Section 274(m)(3) provides that no deduction is allowed for travel expenses of a spouse, dependent or other individual accompanying the taxpayer (or an officer or employee of the taxpayer) on business travel, unless all of the following criteria are met: (1) the accompanying person is an *employee* of the taxpayer; (2) the accompanying person's travel is for a bona fide business purpose; and (3) the travel expenses would otherwise be deductible by the accompanying person. For this purpose, the reference to individuals accompanying the taxpayer does not include business associates.[75] Business associates are persons with whom a taxpayer would reasonably expect to engage or deal in the active conduct of the taxpayer's business.[76]

Treas. Reg. § 1.132-5(t)(1) provides that the disallowance under § 274(m)(3) does not affect the determination of whether the company must report imputed income with respect to the spouse, dependents and personal guests. Accordingly, the classification of these individuals as business or personal travelers is made under the otherwise applicable rules discussed above. In other words, the fact that a spouse is not an employee of the company (as required under § 274(m)(3)) is not relevant to the classification of the spouse's travel for income inclusion purposes.

With respect to the employer's deductions, Treas. Reg. § 1.132-5(t)(1) provides that § 274(m)(3) does not apply if the fringe benefit is reported for the travel by the accompanying spouse, dependent or personal guest. Accordingly, reporting the SIFL value of these individuals' flights precludes § 274(m)(3) from limiting the company's expenses with respect to these flights.

If an accompanying spouse, dependent or personal guest is found to be traveling for business purposes under the ordinary and necessary business expense standards described above (which is relatively rare, as noted above), and the travel is not disallowed under the entertainment disallowance rules, then § 274(m)(3) would apply to limit the employer's deduction with respect to that accompanying individual. In that situation, § 274(m)(3) would typically apply because the accompanying individual is typically not an employee. However, the amount of the disallowance would ordinarily be only the marginal costs of the accompanying individual's travel, which are typically negligible (e.g., additional catering charges). The marginal cost approach appears to apply because (1) the passenger-by-passenger allocation of costs discussed below in Section III.B.2 (Allocation of Costs) only applies with respect to the entertainment disallowance under IRC § 274(e)(2), and (2) the deduction disallowance for accompanying nonbusiness passengers is generally limited to marginal costs.[77]

3. Recordkeeping

IRC § 274(d) provides that no deduction is allowed for travel expenses, entertainment, gifts or with respect to listed property, "unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement" certain specified items. The specified items that must be documented include the amounts, dates, distance traveled, destinations and business purpose.[78] In the case of business entertainment, the documentation also must include information regarding the individuals entertained.[79]

To maintain the required records, a company must maintain an account book, diary, log, statement of expense, trip sheets or similar record and documentary evidence sufficient to establish each of these elements.[80] Typically, the company's cost accounting system and the pilot's logs will provide all of the required information except for the business purpose. Sometimes it is necessary to make sure that the pilots are recording the names of all of the passengers on each flight. It is important that someone (usually an individual in the company's flight department or accounting department) follow up with the passengers to prepare the business purpose descriptions.

The business purpose descriptions should be prepared at or near the time of the flight. This requirement is met if the description is prepared when the individual has full present knowledge of the business purpose of the flight.[81] The degree of detail necessary to establish business purpose will vary depending upon the facts and circumstances. If the business purpose is evident from the surrounding facts and circumstances, a written explanation of such business purpose is not required.[82] For example, no business purpose description would be required for a salesman traveling on his established sales route or for a business meal when the relationship between the individuals is evident from the surrounding circumstances. Nevertheless, as a matter of practice, business purpose descriptions should be prepared on a contemporaneous basis.

If the required business purpose descriptions are not prepared on a contemporaneous basis, they can be prepared later. However, subsequently prepared records must be supported by other corroborative evidence.[83] In general, subsequently prepared records have a lower probative value than contemporaneous records.[84] In numerous cases, the courts have characterized taxpayers' testimony and other noncontemporaneous evidence of business purpose as unreliable, self-serving, contradictory and vague.[85] Therefore, companies should prepare the business purpose descriptions on a contemporaneous basis.

D. CHARTER RATE METHOD

The charter rate method is the method required to calculate the amount of imputed income to an employee for a personal flight, when the SIFL method discussed below in Section II.E (SIFL Rate Method) has not been properly elected. In addition, the charter rate method may be applicable to particular flights for which the SIFL rate method was elected but the SIFL amount was erroneously calculated, as discussed below in Section II.E.5 (Penalties).

In most cases, the imputed income calculated under the SIFL method is lower than under the charter rate method. In addition, determining a comparable charter rate for a flight may be administratively difficult and uncertain. For both reasons, most companies choose to use the SIFL method.

1. Charter Rate Calculations – Employer-Provided Flights

Under the charter rate method, the imputed income to an employee for an employer-provided personal flight is the amount that an individual would have to pay in an arms' length transaction to charter the same or comparable piloted aircraft for that period for the same or comparable flight.[86] In practice, this information is typically obtained by asking charter companies for the hourly rate that they would charge for a flight in a comparable aircraft. The hourly rate is then multiplied by the actual duration of the flight.

The definition of a flight under the charter rate method is the same as under the SIFL method. Therefore, as discussed below in Section II.E.2.a(3) (Deadhead Flights), no imputed income is required for a deadhead flight. In addition, when business is the primary purpose of a trip to both business and personal destinations, only the additional travel attributable to the personal stop would be subject to the imputed income calculation, as discussed below in Section II.E.2.a(2) (Multi-leg Flights).

The charter rate method provides that if an employee's flight is properly valued under the SIFL rate method, no additional amount shall be imputed to that employee under the charter rate method. This special rule seems likely to be most relevant when some flights are not properly valued under the SIFL rate method, and the value is being redetermined on audit using the charter rate method. For example, if the value of a flight would be zero based on the 50 percent seating capacity rule under the SIFL method explained below in Section II.E.3.c (50 Percent Seating Capacity Rule), and zero was in fact imputed to that employee for that flight, then it would appear that due to this special rule no additional amount would need to be imputed to that employee for that flight under the charter rate method.

If there are multiple passengers on the flight, the fair market charter rate is allocated among the passengers. Each employee would be imputed the share of the charter rate attributable to himself or herself and his or her guests. However, if there are one or more control employees, the fair market charter rate is allocated proportionately among the control employees, unless there is a written agreement providing for a different allocation.

a. Definition of Control Employee (for Charter Rate Method Only)

For purposes of the charter rate method, control employees are defined as those employees who control the aircraft by determining the route, departure time and destination of the flight. Note that this definition of control employee differs from the definition of control employee for purposes of the SIFL method as discussed below in Section II.E.2.d (Control Employee Status).

b. Example of Charter Rate Method Calculation

The Treasury Regulations present the following example of the charter rate method.[87]

Employee A wants to go to from New York to Los Angeles for personal reasons. Employee B likewise wants to go from New York to Los Angeles for personal reasons but needs to stop in Chicago for business.

Chicago is an intermediate stop for Employee A and is not included in calculating A's imputed income. Therefore, the amount imputed to A is based on the charter value of a flight from New York directly to Los Angeles.

Chicago is a business destination for Employee B. Therefore, the trip from New York to Chicago is not to be included in calculating B's imputed income. The amount imputed to B is based on the charter value of a flight from Chicago to Los Angeles.

The values of the trips based on charter rates are as follows:

- Total charter value of the entire trip from New York to Chicago to Los Angeles is $1,200.
- The charter value of A's personal trip from New York to Los Angeles is $1,000.
- The charter value of B's personal trip from Chicago to Los Angeles is $600.

The combined charter values of A's and B's personal trips is $1,600 ($1,000 + $600), but the total charter value for the entire trip is only $1,200. Therefore, the total charter value of $1,200 for the entire flight is allocated between A and B in proportion to the relative values of their personal flights.

Value of A's Flight:

Charter value of A's Flight	$ 1,000
Combined charter values of A's and B's flights	÷ 1,600
Charter value of entire flight	× 1,200
Imputed income to A	$ 750

Value of B's Flight:

Charter value of B's Flight	$ 600
Combined charter values of A's and B's flights	÷ 1,600
Charter value of entire flight	× 1,200
Imputed income to B	$ 450

There appears to be an inconsistency between the rule set forth in the regulation and the above example. The regulation states that the charter value is allocated among all employees on the flight, rather than among only the employees traveling for personal purposes. However, the above example seems to suggest that the charter value must be allocated among only the employees traveling for personal

purposes. For example, if there is one passenger traveling for business and one passenger traveling for personal purposes on a flight with a charter value of $1,000, should the amount imputed to the one passenger traveling for personal purposes be $1,000 or $500? The regulation and the example therein appear to be ambiguous on this point.

2. Lease Value Method – Employer-Provided Aircraft Without Pilot

If an employer provides the use of an aircraft to an employee without a pilot, then the imputed income to the employee is the amount that an individual would have to pay to lease a comparable aircraft on the same terms for the same period in the same geographic location.[88] If the employer-provided aircraft benefits multiple employees, then the lease value is allocated among the employees based on the relevant facts and circumstances.

E. SIFL RATE METHOD

The SIFL rates are determined using a formula prescribed in Treas. Reg. § 1.61-21(g). The amount is based on rates determined by the Department of Transportation. The SIFL rates are intended to be approximately double the amount of first-class airfare for a "control employee" and equal to a stand-by coach fare for a non-control employee.

The SIFL rates may be utilized to value domestic and international flights of airplanes or helicopters as long as the travel was not sold on a per seat basis.[89] Thus, the SIFL rates may be used in situations where the aircraft is owned, leased or chartered by the employer.

The SIFL calculation can be performed using the NBAA Personal Use Calculator, which is available on the NBAA web site at www.nbaa.org/taxes.

1. SIFL Calculation

a. Information Needed for SIFL Calculation

The following information is needed to calculate imputed income under the SIFL rate method:

- The point-to-point distance between the two airports on each leg of the trip.
- The SIFL rates and the terminal charge for the six-month period in which the flight occurred.
- Maximum certified takeoff weight (MTOW) of the aircraft.
- The business or personal status of each employee and guest on the flight.
- The control or non-control status of the employees on the flight.

b. Description of SIFL Calculation

The SIFL calculation for each leg of each employer-provided flight with passengers traveling for personal purposes is as follows under Treas. Reg. § 1.61-21(g)(5):

- Step 1: Multiply the number of miles on the leg by the SIFL rate for the six-month period in which the flight occurred to determine the base SIFL fare.
- Step 2: Multiply the base SIFL fare by the aircraft multiple, based on the MTOW of the aircraft and the employee's control or noncontrol status, to determine the adjusted SIFL fare.
- Step 3: To the adjusted SIFL fare, add the terminal charge for the six-month period during which the flight occurred, to determine the SIFL fare per passenger.
- Step 4: Multiply the SIFL fare per passenger by the number of passengers traveling for personal purposes to determine the total SIFL fare.
- Step 5: Subtract any reimbursement received from the employee for the flight.

Each of these steps is explained in more detail below, followed by an explanation of the special rules for bona fide business-oriented security concerns, foreign travel and the 50 percent seating capacity rule.

c. Example SIFL Calculation

Suppose the employer provides to a control employee an 874-mi. flight from St. Louis to Orlando for personal purposes on July 10, 2008. The employee is accompanied by a spouse and two children. Pursuant to a time-sharing agreement, the employee reimburses the employer $1,260 for the flight. The aircraft has a MTOW of 20,000 lbs.

The imputed income at SIFL rates that the employer would report to the employee would be calculated as follows:

Mileage Charge:

First 500 mi. at $0.2312/mi.	$ 116
Next 374 mi. at $0.1763/mi.	+ 66
Base SIFL Fare	182
Aircraft Multiple for Control Employee	× 300%
Adjusted SIFL Fare	545
Terminal Charge	+ 42
SIFL Fare Per Passenger	587
Number of Nonbusiness Passengers	× 4
Total SIFL Fare	2,347
Reimbursement From Employee	(1,260)
Net Taxable SIFL Fare	$ 1,087

d. Tax Reporting

(1) Tax Forms

The proper reporting of the SIFL amounts to the employee depends on the parties' tax situations. In general, the reporting is generally as follows:

Employees – An employer would typically report the SIFL amount on a common law employee's Form W-2.

Independent Contractors – An employer would typically report the SIFL amount for an independent contractor on a Form 1099. A person serving as a director, and not as an employee, would ordinarily be an independent contractor for tax purposes.

Partners or LLC Members – A partnership would report the imputed income to its partner as a guaranteed payment on Schedule K-1 of the partnership's tax return. (Partnerships sometimes report such guaranteed payments on Form 1099, which appears to accomplish the reporting objectives but may be technically incorrect.) The same reporting would apply to a limited liability company (LLC) that is treated as a partnership for tax purposes.

(2) Frequency of Imputed Income; Election to Defer November and December SIFL Reporting

It is permissible to report imputed income and withhold for flights provided to employees on a periodic basis as infrequently as once per year (e.g., as of December 31). It also is permissible to impute income only on flights through the end of October of the current year and report the SIFL value of the November and December flights in the subsequent year's compensation.[90] Presumably, the SIFL amount for the entire calendar year would still be available to subtract from the entertainment disallowance for the calendar year in the calculation described below in Section III (Entertainment Deduction Disallowance).

2. Components of SIFL Calculation

This section explains in more detail the determination of the distance traveled, the SIFL rates and terminal charges, the aircraft multiples and the control employee status of the passengers.

a. Distance Traveled

(1) Statute Miles

The IRS defines a flight as the distance, in statute miles, between the place at which the individual boards the aircraft and the place at which the individual deplanes.[91] Under this definition, each leg of the trip requires a separate SIFL calculation.

If the flight information is provided in nautical miles, it is necessary to multiply the number of nautical miles by 1.15 to convert to statute miles.

The number of miles for a particular leg of the trip is the distance between the two airports, rather than the number of miles that the aircraft actually flies. To determine this distance, one helpful resource is the Airport Distances Calculator within the Personal Use Calculator on the NBAA web site at www.nbaa.org/taxes.

(2) Multi-Leg Flights

(a) Primary Purpose of Trip

If an employee combines, in one trip, personal and business flights on an employer-provided aircraft, and the primary purpose of the trip is business, the SIFL amount is the excess of the SIFL amount calculated on the entire trip over the SIFL amount calculated on the flights that would have been taken if there had been no personal flights.[92]

For example, suppose an executive travels on an employer-provided aircraft from Indianapolis to Tampa, for a business meeting and returns from Tampa to Indianapolis, with a stopover at Pensacola for personal reasons. Assume that the primary purpose of the trip is the business meeting and the stopover in Pensacola for personal reasons was incidental. The SIFL amount for the trip would be calculated as follows:

- Calculate the SIFL amount for all three legs of the trip, as if the entire trip were for personal purposes.
- Calculate the SIFL amount for a hypothetical business trip from Indianapolis to Tampa and directly back to Indianapolis without the stopover in Pensacola.
- The SIFL amount to impute to the employee would be the excess of the SIFL amount for the whole trip (#1) over the SIFL amount for the hypothetical business trip to Tampa and back (#2).

In contrast, suppose the stopover in Pensacola was the primary purpose for the trip and the detour to Tampa for business was merely incidental. In that case, the amount of imputed income would be the SIFL amount calculated on a hypothetical trip from Indianapolis to Pensacola and directly back to Indianapolis, without a stop in Tampa.

(b) Intermediate Stop

The IRS defines an intermediate stop as a landing necessitated by weather conditions, an emergency, refueling or any other purpose unrelated to the personal purposes of the employee whose flight is being valued.[93] An intermediate stop with respect to an employee would include a stop to accommodate another passenger for a purpose unrelated to the employee's purpose for traveling. The additional mileage attributable to an intermediate stop with respect to an employee is not considered when determining the distance of that employee's flight in the SIFL calculation.

For example, suppose an employer provides a flight from Washington, DC to Atlanta, then continuing on to Orlando. Control Employees A and B and their respective guests are traveling to Orlando for personal purpose and have no interest in stopping in Atlanta. Control Employee C and her guest's destination is Atlanta. The imputed income at SIFL rates for A and B is determined based on the distance from Washington, DC directly to Orlando, since Atlanta represents an intermediate stop for them.

(3) Deadhead Flights

For purposes of the SIFL rate method, a flight is the distance, in statute miles, between the place at which the individual boards the aircraft and the place at which the individual deplanes.[94] Based on this rule, no SIFL income needs to be imputed to anyone for flights with no passengers such as deadhead or repositioning flights. In contrast, deadhead flights must be included in the entertainment deduction disallowance calculation discussed below in Section III.B.2.c (Deadhead Flights).

b. SIFL Rates

The SIFL rates are calculated and updated by the U.S. Department of Transportation every six months. The IRS publishes the SIFL rates and terminal charges for the six-month periods of January to June and July to December. These rates are available on the NBAA web site at www.nbaa.org/taxes.

The SIFL rates are presented as one rate per mile for the first 500 miles, another rate for the next 1,000 miles and a third rates for miles in excess of 1,500 miles. This schedule of rates is applied separately to each leg of a trip.

c. Aircraft Multiples

The aircraft multiple depends on the maximum certified takeoff weight of the aircraft and whether the income is to be imputed to a control or non-control employee.

The aircraft multiples listed in Treas. Reg. § 1.61.21(g)(7) are as follows and do not change from year to year:

Maximum Certified Takeoff Weight of the Aircraft	Aircraft Multiple for a Control Employee	Aircraft Multiple for a Non-Control Employee
6,000 lbs. or less	62.5%	15.6%
6,001–10,000 lbs.	125%	23.4%
10,001–25,000 lbs.	300%	31.3%
25,000 lbs. or more	400%	31.3%

Since it is possible to have imputed income for both control and noncontrol employees on a single leg of a trip, it is possible that different aircraft multiples would be applied to the SIFL calculations for different employees on a single leg.

If there is a bona fide business-oriented security concern and certain other requirements are met, then the maximum aircraft multiple is capped at 200 percent.[95] This special rule is discussed below in more detail in Section II.E.3.a (Business-Oriented Security Concerns).

d. Control Employee Status

To determine which aircraft multiple to use, it is necessary to determine the control or noncontrol employee status of the employee to whom the passenger's personal flight is taxed. This section of the *Personal Use Handbook* provides a general explanation of the definition of control employee. In many cases, only individuals who are obviously control employees have the right to use the aircraft for personal purposes. However, the definition of control employee is surprisingly complex, and in some cases it is necessary to consult the Treasury Regulations to determine whether the individual is a control employee.

(1) Definition of Control Employee

In general terms, a control employee is an officer, highly compensated employee, 5 percent owner or director. More specifically, the IRS defines control employee in Treas. Reg. § 1.61-21(g)(8)(i) for a non-government employer as any employee:

- Who is a board- or shareholder-appointed, confirmed or elected officer of the employer, limited to the lesser of: 1 percent of all employees (increased to the next higher integer, if not an integer), or 10 employees,
- Who is among the top 1 percent most highly paid employees of the employer (increased to the next higher integer, if not an integer) and limited to a maximum of 50,
- Who owns a 5 percent or greater equity, capital or profit interest in the employer, or
- Who is a director of the employer.

This control employee relationship is determined with respect to the employer of the employee, which is the entity to which the employee provides the services in return for which the fringe benefit flight is provided.[96] The employer for this purpose need not be the same entity that actually provides the flight to the employee. See Section II.B.3 (Identification of "Employer") above.

An employee whose compensation is below $50,000 cannot be classified as a control employee under tests A or B above.[97] The $50,000 threshold is adjusted annually for inflation.

As explained above in Section II.B.1 (Personal Flights Provided to Service Providers – Referred to as "Employees"), the term "employee" for purposes of the SIFL rate method generally refers to common law employees, directors, partners and independent contractors. However, for purposes of the highly compensated employee test (test B above), the term employee is modified to include only common law employees, partners and 1 percent or greater shareholders.[98]

(2) Former Employees

Former employees who are provided a flight on a former employer's aircraft for personal purposes will have imputed income, because the flight is provided in connection with their prior service to the employer. The regulations provide special rules for determining control employee status of former employees.[99] Under these rules, an employee who was a control employee at anytime after reaching age 55 or within three years of separation of service will be treated as a control employee. Former employees classified as control employees are not counted in determining the maximum number of employees who can be considered control employees under the definition of control employees.

(3) Personal Guests

As explained above in Section II.B.2 (Guests of Employees), the SIFL value of a guest's flight is reported as income to the employee, rather than to the guest. Consistent with this principle, the control or noncontrol status of the guest is determined by the control or noncontrol status of the employee.[100] In other words, a flight provided to the personal guest of a control employee will be valued using the control employee aircraft multiple.

(4) Family Members

A family member of a control employee is automatically a control employee.[101] For this purpose, family members include siblings, spouse, ancestors and lineal descendants.[102]

(5) Aggregation Rules

To test the compensation of an employee for purposes of the highly compensated employee test (test B), it is necessary to treat as a single employer all companies that are subject to aggregation under certain compensation rules.[103] Those aggregation rules are set forth in IRC § 414(b), (c), (m) and (o), and they generally include affiliated groups of corporations and other entities, and affiliated service groups.

Under the 5 percent owner test (test C) and the 1 percent owner test (to determine employee status for purposes of test B), an individual's ownership of any entity is determined based on direct and indirect ownership principles under IRC § 318(a).[104] For purposes of these tests, if an individual is a 5 percent (or 1 percent) owner of an entity, that individual is considered to be a 5 percent (or 1 percent) owner of all entities subject to aggregation under IRC § 414(b), (c), (m) and (o).

However, for purposes of the officer and director tests (tests A and D), officer and director status is determined on an entity-by-entity basis. In other words, being an officer or director of one corporation does not cause the individual to be treated as a control employee of another corporation.

3. Special Rules

a. Business-Oriented Security Concerns

If a "bona fide business-oriented security concern" exists with respect to a particular employee, and the employer requires that the employee travel on employer-provided aircraft for personal trips, then the employer may exclude from the employee's gross income the excess value of the flight over the "safe harbor airfare."[105]

To be eligible to apply this rule, the employee must qualify as an "employee" under Treas. Reg. § 1.132-1(b)(2).[106] Under Treas. Reg. § 1.132-1(b)(2), "employee" means: (1) an individual currently employed by the employer; (2) a partner who performs services for the partnership/employer; (3) a director; and (4) an independent contractor. If a bona fide business-oriented security concern exists with respect to such an "employee," then the requisite security concern is also deemed to exist with respect to the employee's spouse and dependents, who concurrently travel with the employee on personal flights.[107] When the employee's spouse and dependents travel without the employee, the bona fide business-oriented security concern will exist for them only if the requirements discussed below are met for the spouse and dependents.

A bona fide business-oriented security concern exists only if the facts and circumstances establish a specific basis for concern regarding the safety of the employee.[108] A generalized concern for the safety of the employee is not sufficient.

In addition, the employer must either establish an "overall security program" for the employee, or have an "independent security study" prepared for the employee.[109] An overall security program requires that security be provided to protect the employee on a 24-hour basis.[110] An "independent security study" must meet the following requirements: (1) it must be performed with respect to the employer and the employee by an independent security consultant; (2) it must be based on an objective assessment of all facts and circumstances; (3) the recommendation of the security study must be that an overall security program is not necessary and that the recommendation is reasonable under the circumstances; and (4) the employer must apply the specific security recommendations contained in the security study to the employee on a consistent basis.[111]

If the above criteria for a bona fide business-oriented security concern are met, then the employee's income is determined under the SIFL rate method except that the aircraft multiple is capped at 200 percent.[112] The same SIFL rate would apply to the employee's spouse and dependents if a bona fide business-oriented security concern exists for them under the rules discussed above, and the employer requires that they travel on the employer-provided aircraft for the personal trip.

b. Foreign Travel

(1) Foreign Travel for More Than Seven Days

The foreign travel disallowance rule under IRC § 274(c) applies to a trip outside the United States when both of the following conditions are met: (a) the trip outside the United States lasts for more than seven days, and (b) at least 25 percent of the individual's time on the trip is devoted to nonbusiness activities. Under Treas. Reg. § 1.274-4(d)(2), the 25 percent threshold is measured on a day-by-day basis. If both conditions are met, then the disallowance rule applies to the costs of the foreign trip multiplied by the ratio of the number of nonbusiness days divided by the total number of days.[113]

Rules for determining the number of business and nonbusiness days are provided in Treas. Reg. § 1.274-4(d)(2). Under these rules, the travel days out of and into the U.S. are considered business days.[114] Any day that the taxpayer's presence is required for business purposes at the foreign location is considered a business day.[115] Intervening weekends are generally counted as business days.[116]

This foreign travel disallowance rule only applies to "individuals" as provided in § 274(c). Treas. Reg. § 1.274-4(a) makes it clear that this disallowance rule does not apply to an "employer." Accordingly, this provision cannot result in the disallowance of expenses for the employer.

Instead of causing the disallowance of the employer's deduction, the foreign travel disallowance results in the inclusion in the employee's income of a portion of the SIFL amount that would otherwise apply if the trip were entirely nonbusiness.[117] The SIFL income amount would be determined as follows:

1. Determine the number of personal days and the number of business days on the trip outside the U.S. Divide the personal days by the total days to determine the personal days percentage. If the percentage exceeds 25 percent and the trip is outside the U.S. for more than seven days, then the foreign travel disallowance rule applies.
2. Calculate the SIFL amount for the trip as if the trip were entirely personal.
3. Multiply this SIFL amount by the personal days percentage to calculate the SIFL income inclusion.

Of course, this foreign travel rule would not be relevant to a passenger whose primary purpose on the trip is personal, because the SIFL amount for the entire trip would be imputed to that individual.

In contrast, in the case of a sole proprietor, the foreign travel rule would cause the disallowance of the personal days percentage of the sole proprietor's costs of the flight.

The foreign travel disallowance rule in § 274(c) applies for purposes of IRC §§ 162 and 212. There is no authority in the foreign travel disallowance in § 274(c), the entertainment disallowance in § 274(a), or the Treasury Regulations under either of those sections to support applying the foreign travel disallowance to the entertainment disallowance rules discussed below in Section III (Entertainment Deduction Disallowance).

(2) Travel to Conventions or Seminars Outside North America

With respect to attendance at conventions, seminars or similar meetings held outside the North American area, no deduction shall be allowed under § 162 for expenses allocable to such meetings unless the taxpayer establishes that the meeting is directly related to the active conduct of his trade or business and that taking into account:

- The purpose of such meeting and the activities taking place at such meeting,
- The purposes and activities of the sponsoring organizations or groups,
- The residences of the active members of the sponsoring organization and the places at which other meetings of the sponsoring organization or groups have been held or will be held, and
- Such other relevant factors as the taxpayer may present, it is as reasonable for the meeting to be held outside the North American area as within the North American area.[118] This criteria may be met for example, if the selected location outside of the North American area is a central location for a multi-national company.

c. 50 Percent Seating Capacity Rule

(1) Meeting the 50 Percent Seating Capacity Test

The 50 percent seating capacity rule applies if 50 percent or more of the regular passenger seating capacity of an aircraft (as used by the employer) is occupied by individuals whose flights are primarily for the employer's business and whose flights are excludable from income under IRC § 132(d).[119] As the term "individual" is not restricted, it presumably would include employees, partners, independent contractors, directors and other individuals such as customers whose flights are provided primarily for the employer's business.

In the calculation of whether business passengers fill 50 percent of the aircraft's "regular seating capacity," the regular seating capacity includes all seats that are belted and approved for take-off and landing less any required crewmember seats.[120] The regular seating capacity of the aircraft is the maximum number of seats on the aircraft during a 24-month period, unless the seats were permanently removed and not reinstalled in the 24-month period.[121] If a seat is reinstalled, even for one flight, it is included in the count for the entire period including previous flights in the 24-month period. Seats include jump seats and removable seats used solely for the purposes of flightcrew training.

Seats occupied by flightcrew are not included in the regular seating capacity, and such members of the flightcrew are not counted in reaching the 50 percent threshold.[122] It is not clear whether flightcrew is limited to those individuals required by FARs and the original equipment manufacturer's specifications to operate the aircraft, or whether flightcrew has a more general meaning such as those individuals primarily on the aircraft to provide the flight service rather than to travel to the destination. The example in Treas. Reg. § 1.61-21(g)(12)(v) might be read to support the latter interpretation.

(2) Benefits of the 50 Percent Seating Capacity Rule

If the 50 percent seating capacity test is met for a flight, no SIFL income would need to be imputed for a common law employee, a partner, or their accompanying spouse and dependent children traveling for personal purposes on that flight.[123] However, independent contractors, directors and their guests traveling for personal purposes would be subject to imputed income at the noncontrol employee SIFL rate (even if they were control employees). In addition, guests of common law employees and partners, other than accompanying spouse and dependent children, would also be subject to imputed income at noncontrol employee

SIFL rates, if traveling for personal purposes. For example, if the 50 percent seating capacity test is met, there would be no imputed income for the accompanying spouse of a common law employee traveling for personal purposes, but SIFL income would be calculated at noncontrol employee rates for a cousin of a common law employee traveling for personal purposes.

4. Consistency Rules

The charter rate method is the default method, and the SIFL rate method is a special valuation method that the employer can elect if it complies with the requirements of the SIFL rate method. One of the requirements is the consistency requirement, which provides that if the employer elects to use the SIFL rate method in any particular year, it must use that method for all of its employees during that year.[124] An exception to this consistency rule provides that the charter rate method may be used for entertainment flights for all specified employees, while the SIFL rate method is used for all other flights.[125]

5. Penalties

It is important that the SIFL rules be applied correctly. If it is subsequently determined that the SIFL rules were not applied correctly to an employee on a flight, then the SIFL rules may not be available for that employee on that flight, and the imputed income for that employee on that flight would have to be redetermined using the charter rate method.[126] The regulations provide the following nonexclusive list of errors that will trigger this penalty:

- Treating a control employee as a noncontrol employee;
- Classifying the aircraft in too low a weight classification for purposes of determining the aircraft multiple;
- Applying the 50 percent seating capacity rule to a passenger who did not qualify for it; or
- Classifying a passenger traveling for personal purposes as business.

In addition, failure to properly report the SIFL amount on information returns (e.g., Form W-2, Form 1099, Schedule K-1) can result in information return reporting penalties specific to those returns.

In the case of personal nonentertainment flights (discussed below in Section III.B.1.a(2)), the failure to report imputed income may prompt the IRS to seek to deny the employer's deduction for the cost of the flights.[127] However, after the October 23, 2004, effective date of the American Jobs Creation Act of 2004, the requirement in IRC § 274(e)(2) that the fringe benefit be reported to the employee as a prerequisite to claiming the compensation exception to the entertainment disallowance would seem irrelevant with respect to a flight provided to a specified individual. The 2004 amendment to § 274(e)(2) disallows the employer's deduction (in excess of the imputed income reported to, or reimbursement received from, the employee) of entertainment flights provided to specified individuals, irrespective of whether or not the imputed income was reported to the employee.

F. SECURITIES AND EXCHANGE COMMISSION REPORTING

The portion of the regulations that relates to personal use of the corporate aircraft is contained in the Code of Federal Regulations 17, subpart 229.402 (item 402), Executive Compensation.

Generally speaking, corporate reporting affects publicly traded companies with greater than $10 million in assets and greater than 500 shareholders. However, the Securities and Exchange Commission (SEC) rules differ significantly from the tax rules. The SEC's stated primary mission is to protect investors and maintain the integrity of the securities markets. As mentioned earlier, SEC laws and rules must be followed by publicly held companies; their rules do not affect closely held companies. By enforcing its rules, the SEC – with its civil powers and the criminal powers of the Justice Department – increases the amount, accuracy, consistency and comparability of information available to investors.

The amount imputed to an employee (under either the SIFL or charter rate methods) for tax purposes under the IRS rules have nothing to do with the amount to be reported to the SEC.

For SEC reporting purposes, all annual and long-term compensation for top executives of reporting companies must be disclosed. Note that 17 C.F.R. § 229.402, item 402(b)(2) describes the information to be reported, which includes salary, bonus and other annual compensation. Additional annual compensation includes perquisites, i.e., personal use of the corporate aircraft, item 402(C)(1), which should be reported at their "aggregate incremental cost," unless the aggregate amount of such compensation is the lesser of either $50,000 or 10 percent of the total annual salary and bonus reported for the named executives.

Item 402(a)(2) All Compensation Covered. This requires clear, concise, and understandable disclosure of all plan and non-plan compensation awarded to, earned by, or paid to named executive officers and directors.

Item 402(a)(3) Persons Covered. Persons covered include the CEO, the four most highly compensated executive officers and up to two more individuals for whom disclosure would have been required except that the individual was not serving as an executive officer at the end of the last fiscal year.

Instructions to item 402(b)(2)(iii)(C)1. Each perquisite or other personal benefit exceeding 25 percent of the total perquisites and other personal benefits reported for a named executive officer must be identified by type and amount in a footnote or accompanying narrative discussion.

In summary, depending on a company's unique circumstances, personal use of the corporate aircraft could result

in public reporting of the aggregate incremental cost. Although there is not an official definition of aggregate incremental cost, it generally is interpreted to mean the variable or direct operating cost of the aircraft. These are costs that only are incurred because the aircraft was flown, unlike fixed costs, which are incurred and will be paid regardless of whether the aircraft remains in the hangar or is flown.

G. TIME-SHARING AGREEMENTS

1. Reimbursements Permitted by Tax Laws but Not by the FAA

As discussed above in Section I (FAA Regulatory Considerations), companies operating aircraft under FAR Part 135 may accept reimbursements for flights, but those operating under FAR Part 91 may accept reimbursement only in limited circumstances, such as pursuant to time-sharing arrangements. The tax laws do not prohibit employees from reimbursing employers for the cost of personal flights. Such reimbursements reduce the amounts of the employee's imputed income and the employer's entertainment disallowance.

In some cases, employees would like to reimburse the company with respect to personal flights, for various reasons such as to offset SIFL income otherwise imputed to the employee and minimize SEC reporting of perquisites in the case of publicly traded corporations. A company providing a flight under Part 135 may accept such reimbursements. However, if the flight is provided under Part 91, the employer and employee may want to enter into a time-sharing agreement to enable the employee to pay at least a limited reimbursement to the company.

2. FAA Rules Governing Time-Sharing Agreements

FAR § 91.501(b)(6) allows for the carriage of company officials, employees and guests of the company on an airplane operated under a time-sharing, interchange or joint ownership agreement as defined in § 91.501(c).

FAR § 91.501(c)(1) defines a time-sharing agreement as an arrangement whereby a person leases his or her airplane with flightcrew to another person, and no charge is made for the flights conducted under that arrangement other than those specified in § 91.501(d).

Regarding FAR § 91.501(d), the following may be charged, as expenses of a specific flight, for transportation as authorized by paragraphs (b)(3) and (b)(7) and (c)(1).

- 91.501(b)(3) – demonstration flights
- 91.501(b)(7) – carriage of property
- 91.501(c)(1) – time sharing.

For these three operations alone, FAR § 91.501(d) provides that the items listed below may be charged:

1. Fuel, oil, lubricants and other additives
2. Travel expenses of the crew, including food, lodging, and ground transportation
3. Hangar and tie-down costs away from the aircraft's base of operations
4. Insurance obtained for a specific flight
5. Landing fees, airport taxes and similar assessments
6. Customs, foreign permits and similar fees directly related to the flight
7. In-flight food and beverages
8. Passenger ground transportation
9. Flight planning and weather contract services
10. An additional charge, equal to 100 percent of the expenses listed in item #1 above

This list of permissible charges is a *maximum* amount. Notice that item #1 is the actual fuel burn for the flight and item #10 is twice the amount of item #1. Thus, item #10 will help offset some costs which are not otherwise listed and not allowed to be charged. These costs include pilot salaries, maintenance reserves, hangar rent and depreciation. It is an intended result that the company will not recover a fully allocated cost. The costs to be recovered, if listed in items #2 through #9, are a portion of the expenses resulting from the movement of the aircraft.

The time share is a wet-lease or with-crew transportation arrangement. As such it is subject to the federal transportation excise tax and FAR § 91.23, Truth in Leasing Clause Requirement in Leases and Conditional Sales Contracts. More information about the federal transportation excise tax and FAR § 91.23 is available at www.nbaa.org/taxes.

3. Availability of Time-Sharing Agreements

FAR § 91.501(a) applies only to operation of large and of turbojet-powered multi-engine civil airplanes of U.S. registry. If the aircraft does not qualify, the owner may opt into § 91.501 operations by applying to the FAA directly for an exemption or by becoming a member of NBAA and satisfying the requirements of NBAA's Small Aircraft Exemption. The steps and details are available at www.nbaa.org.

H. FREQUENTLY ASKED QUESTIONS (FAQ) ABOUT PERSONAL USE

Questions

Below is a list of the frequently asked questions on the topic of empty seat/personal use of employer-provided aircraft that will be answered in this document. Each answer is preceded by the section number from the Treasury Regulations.

- Can you use the valuation formula in the regulations for international flights?
- Does this valuation formula apply to helicopters as well?
- What do we do if the individual flying on the aircraft is not an employee or personal guest of any employee of the company?
- What is the definition of a *control employee*?
- What is the definition of an *employee*?
- What is the 50 percent rule, and who can fly and realize a zero valuation?
- How do you determine the seating capacity of an aircraft?
- When is a flight taxable?
- What is considered a bona fide business-oriented security concern?
- Can an employee pay for the fringe benefit?
- What is SIFL?
- Do SIFL rates change? If so, how often, and how will we (NBAA Members) know when they have?
- Do we charge a terminal charge for each person or just once for the aircraft? How often do I charge this?
- Do I use statute or nautical miles?
- Do I have to use SIFL rates? If not, what other method is there?
- How do you value a flight?
- What if there is an intermediate stop?
- How do you compute?

Answers

Q: Can the SIFL rules still be used for reporting the value of personal flights provided by an employer?
A: Yes. The SIFL rules may still be used for reporting the value of personal flights provided by an employer. However, subsequent to 2004, the amount deductible on the employer's tax return may be decreased for certain flights by certain employees.

Q: Can the SIFL valuation formula in the regulations for international flights?
A: *Treas. Reg. § 1.61-21(g)(2)*. Yes. The valuation rule may be used to value international, as well as domestic flights.

Q: Can the SIFL valuation formula in the regulations be used for flights provided by the employer through a charter operator?
A: *Treas. Reg. § 1.61-21(g)(2)*. Yes. The valuation rule may be used to value charter flights and all flights provided by an employer other than those where seats are sold on an individual basis to the public.

Q: Does this valuation formula apply to helicopters as well?
A: *Treas. Reg. § 1.61-21(g)(2)*. Yes. The valuation rule of this paragraph may be used to value flights on all employer-provided aircraft, including helicopters.

Q: What do we do if the individual flying on the aircraft is not an employee or personal guest of any employee of the company?
A: *Treas. Reg. § 1.61-21(g)(4)(v)*. If the individual flying on the aircraft is not an employee or personal guest of any employee of the company, the flight by the individual is not taxable to any employee of the employer providing the flight. The rule in the preceding sentence applies only where the individual is provided the flight by the employer for noncompensatory business reasons of the employer. However, it can also be determined on a facts and circumstances basis.

Q: What information do I need to calculate personal use under the SIFL method?
A: The mileage of the personal component of the employer-provided flight, the status of the employee as control or non-control, and the weight of the aircraft.

Q: Can you provide an example of the computation for control and non-control employees?
For purposes of this example, assume a simple flight of one control and one non-control employee, each flying with their spouses. They are flying from A to B and back to A with no stops in between. The distance from A to B is 1,700 miles. And the maximum certified takeoff weight of the aircraft is over 25,000 pounds.

Here are the calculations:

For the Control Employee
First compute using the SIFL rates. Note: SIFL rates change every six months. The rates used below are for demonstration only. For the latest SIFL rates visit the NBAA web site at www.nbaa.org/taxes.

0–500 miles = $.1684 (500 x .1684 = $84.20)
500–1,500 miles = $.1284 (1,000 x .1284 = $128.40)
Over 1,500 miles = $.1235 (200 x .1235 - $24.70)

$84.20 + $128.40 + $24.70 = $237.30

Now multiply this amount ($237.30) by the appropriate aircraft multiple (400%):
$237.30 x 400%o = $949.20

Now add in the terminal charge ($30.79):
$949.20 + $30.79 = $979.99

Now multiply by the number of flights, which in this case is two (2) because it was a round trip:
$979.99 x 2 = $1,959.98

Now multiply by the number of individuals, which in this case is two (2), control employee and spouse:
$1,959.98 x 2 = $3,919.96

This amount ($3,919.96) is the amount includible in the control employee's income.

For the Non-Control Employee
First compute using the SIFL rates (same as above). Note: SIFL rates change every six months. The rates used below are for demonstration only. For the latest SIFL rates visit the NBAA web site at www.nbaa.org/taxes.

0–500 miles = $.1684 (500 x .1684 = $84.20)
500–1,500 miles = $.1284 (1,000 x .1284 = $128.40)
Over 1,500 miles = $.1235 (200 x .1235 - $24.70)

$84.20 + $128.40 + $24.70 = $237.30

Now multiply this amount ($237.30) by the appropriate aircraft multiple, which in this case is 31.3 percent because this employee is not a control employee:
$237.30 x 31.3% = $74.27

Now add in the terminal charge ($30.79):
$74.27 + $30.79 = $105.06

Now multiply by the number of flights, which in this case is two (2) because it was round trip:
$105.06 x 2 = $210.12

Now multiply by the number of individuals, which in this case is two (2), employee and spouse:
$210.12 x 2 = $420.24

This amount ($420.24) is the amount includible in the employee's income.

Q: What is the definition of a control employee?
A: *Treas. Reg. § 1.61-21(g)(8)* provides that a control employee is an employee:

1. Who is a board- or shareholder- appointed, confirmed or elected officer of the employer, limited to the lesser of: (a) 1 percent of all employees (increased to the next higher integer, if not an integer), or (b) 10 employees.

2. Who is among the top 1 percent most highly paid employees of the employer (increased to the next higher integer, if not an integer, and limit to a maximum of 50).

3. Who owns a 5 percent or greater equity, capital or profit interest in the employer.

4. Who is a director of the employer.

Q: What is the definition of an employee?
A: *Treas. Reg. § 1.132-1(b).* An employee is a common law employee or independent contractor employed by the employer in the line of business, who was formerly employed by the employer who separated from service with the employer by reason of retirement or disability, any widow or widower of an individual employed by the employer or who separated from service with the employer by reason of retirement or disability. Any partner who performs services for a partnership is considered employed by the partnership. In addition any use by the spouse, dependent children or parent of the employee will be treated as use by the employee.

Q: What is the 50 percent rule, and who can fly and realize a zero valuation?
A: *Treas. Reg. § 1.61-21(g)(12).* Where 50 percent or more of the regular seating capacity of an aircraft is occupied by individuals whose flights are primarily for the employer's business, the value of a flight on that aircraft by any employee or employee's spouse or dependent who is not flying primarily for the employer's business (personal use) is deemed to be zero. Other guests of an employee result in imputed income to the employee in an amount calculated as if the employee were a noncontrol employee.

Q: How do you determine the seating capacity of an aircraft?
A: *Treas. Reg. § 1.61-21(g)(12)(iii)–(v).* Except as otherwise provided, the regular passenger seating capacity of an aircraft is the maximum number of seats that have at any time on or prior to the date of the flight been on the aircraft (while owned or leased by the employer).

Special Rules: A company can permanently reduce the seating capacity of an aircraft. However, if the company then restores some seats within 24 months, the IRS will ignore the reduction in seating capacity.

Seating capacity includes only seats that may legally be used during takeoff provided that the seats that cannot be legally used are, in fact, not used.

Q: When is a flight taxable?
A: Any time an individual travels aboard a company's aircraft for reasons not related to the company's business, the flight is potentially taxable to an employee.

Q: What is considered a bona fide business-oriented security concern?
A: *Treas. Reg. § 1.132-5(m).* The regulations provide the following examples of factors indicating the existence of bona fide business-oriented security concerns – death threats, threats of kidnapping or serious bodily harm and a history of violent terrorist activity in the relevant geographic area.

The regulations also provide that if a bona fide business-oriented security concern is deemed to exist for an employee, then such concern is deemed to exist with respect to the spouse and dependents of that employee.

Q: Can an employee pay for the fringe benefit?
A: *Treas. Reg. § 1.61-21(b).* Yes. However, the FAA does not allow for reimbursement of personal use of the corporate aircraft (FAA Counsel Opinion 8/8/93) unless the aircraft operates under Part 135 or a timeshare agreement is in place.

Q: What is SIFL?
A: *Treas. Reg. § 1.61-21(g)(5).* The Standard Industry Fare Level (SIFL) is a statistic maintained by the U.S. Department of Transportation to measure the "reasonableness" of an airline fare since deregulation. The IRS adopted it as a yardstick against which to measure the value of taxable non-business transportation aboard employer-provided aircraft. The SIFL has two parts: a mileage computation, using three ranges of statute miles and a terminal charge. The three ranges of statute mileage – 0 to 500, 501 to 1,500, and over 1,500 – have their own cents-per-mile value. The mileage component is then multiplied by a number based on the weight of the aircraft and the control or non-control status of the employee.

Q: Do SIFL rates change? If so, how often, and how will we (NBAA Members) know when they have?
A: The SIFL rates change every six months (January 1 through June 30 and July 1 through December 31). All NBAA Members will be alerted of the changes via the NBAA web site at www.nbaa.org and other means.

Q: Do we charge a terminal charge for each person or just once for the aircraft? How often do I charge this?
A: The terminal charge is charged for each person flying on the aircraft. In addition, this charge is used for each leg of the trip (both going and returning).

Q: Do I use statute or nautical miles?
A: *Treas. Reg. § 1.61-21(g)(3)(i).* A flight is the distance in statute miles between the place at which the individual boards the aircraft and the place at which the individual deplanes.

Q: Do I have to use SIFL rates? If not, what other method is there?
A: *Treas. Reg. § 1.61-21(b)(6), (7).* The value of a flight deemed taxable can be computed two ways. First is by how much it would cost a hypothetical person to charter the same or comparable aircraft for the same or comparable flight for flights provided with a crew. Second is by the non-commercial flight special valuation rule (using SIFL rates). However, the charter rate method will, in most cases, result in the higher of the two valuation methods allowed. The consistency rules in Treas. Reg. § 1.61-21(g)(14)(i), (ii) provide that if the SIFL rules are used for one employee's flight, they must be used for all flights with the exception of entertainment flights for specified employees.

Q: How do you value a flight?
A: *Treas. Reg. § 1.61-21(g)(3)(ii).* Under the valuation rule of this paragraph, value is determined separately for each flight. Thus a round-trip is comprised of at least two flights.

Q: What if there is an intermediate stop?
A: *Treas. Reg. § 1.61-21(g)(3)(iii).* Additional mileage attributable to an intermediate stop not related to the employee is not considered when determining the distance of an employee's flight.

III. Entertainment Deduction Disallowance for Personal Flights

This section of the *Personal Use Handbook* explains the entertainment disallowance for sole proprietorships (Section III.A below) and for companies that provide flights to their employees (Section III.B below).

A. SOLE PROPRIETORS

1. Description of Sole Proprietor Flights

As used herein, the term sole proprietor refers to an individual who provides flights to himself or herself, rather than having the flights provided by his or her employer. A sole proprietor would include an individual who owns an aircraft or leases it from another party, and who pilots the aircraft or hires the pilot. The sole proprietorship rules also apply to flights provided by a single member LLC to its sole owner if the owner is an individual, assuming the single-member LLC is disregarded for federal income tax purposes. (Note that it is generally not advisable for a single member LLC to provide both the aircraft and the pilot, because it may be treated as a "flight department company" for FAA purposes and it may incur federal transportation excise taxes.)

2. Classification of Flights

The costs of a flight provided by a sole proprietorship to its sole proprietor primarily for the purposes of a business owned by the sole proprietor ordinarily would be deductible as transportation costs incurred by the sole proprietor's business. The SIFL rules would not apply to a sole proprietor's flight because there would be no employer-employee relationship.

In general, personal flights by sole proprietors are nondeductible. The distinction between business and personal flights discussed above in Section II.C (Distinguishing Personal Flights from Business Flights) would apply to flights provided by a sole proprietorship to its sole proprietor.

Section III.B.1.a(2) (Personal Nonentertainment Flights) discusses the ability of employers to deduct the costs of flights provided to employees for nonentertainment purposes. This exception for nonentertainment flights is not available to sole proprietors, because it relies on the flights being deductible as the cost of an employer-provided fringe benefit.

Section III.B.1.a(3) (Entertainment Flights) discusses the disallowance of costs to travel for entertainment purposes, even to entertain employees, suppliers or customers, unless the travel is "directly related" to business or is "associated with" business and is incurred immediately preceding or following a substantial business discussion. This disallowance of entertainment flights would apply to sole proprietors as well.

3. Allocation of Costs – Primary Purpose Method

In the case of a sole proprietor's flights incurred in connection with business (either the sole proprietor's business or that of the sole proprietor's employer), costs are allocated among

the sole proprietor's flights in proportion to the miles or hours of the flight (referred to herein as the primary purpose method).[128] The business purpose of each flight is determined based on the primary purpose of the flight.[129] There does not appear to be any requirement to allocate the cost of a flight among each passenger to determine its deductibility.

4. Sole Proprietor Flights for an Employer

Flights by a sole proprietor on the business of the sole proprietor's employer may be employee business expenses of the sole proprietor, subject to the 2 percent of adjusted gross income threshold applicable to miscellaneous itemized deductions. On the other hand, providing the aircraft services separately (possibly through a time-sharing agreement) may enable the sole proprietor to treat it as a separate activity not subject to the 2 percent of AGI floor on miscellaneous itemized deductions. In addition, to the extent that costs are reimbursed by the sole proprietor's employer in the amount of some or all of the costs in accordance with the rules governing an "accountable plan," the costs of such flights could be offset by the reimbursements received.

Individuals who provide their own aircraft to travel on the business of their employer should consider entering into an agreement with their employer regarding reimbursements, or requesting that their employer adopt a policy regarding reimbursements. Otherwise, unreimbursed costs risk being treated as nonbusiness.[130]

Caution should be exercised in accepting reimbursements from an employer with respect to aircraft operated under FAR Part 91, since there may be FAA concerns with such reimbursements as discussed above in Section I (FAA Regulatory Considerations).

5. Comparison With Employer-Provided Flights

The ability of a sole proprietor to use the primary purpose method to allocate costs is generally an advantage over the passenger-by-passenger allocation methods required for employer-provided flights, because it allows guests of the sole proprietor traveling for nonbusiness purposes to be ignored when the flight is primarily for business purposes. However, a sole proprietorship has the disadvantage of having the costs of all personal flights disallowed irrespective of whether the flights are for entertainment or nonentertainment purposes.

B. EMPLOYER-PROVIDED FLIGHTS

As explained above in Section II (Imputed Income for Personal Flights), when an employer provides a flight to an employee as a fringe benefit for services, the value of the flight must be reported to the employee as a taxable fringe benefit. Most employers elect to report the value of the flight as SIFL rates.

Prior to the October 23, 2004, effective date of the American Jobs Creation Act of 2004 (the "Jobs Act"), the case of *Sutherland Lumber-Southwest, Inc. v. Commissioner,* 255 F.3d 495 (8th Cir. 2001), *acq.* 2002-1 C.B. xvii, held that the entertainment disallowance under IRC § 274(a) did not prevent the deduction of the cost of personal flights provided to employees, because such flights fell within the exception in § 274(e)(2) for costs incurred to provide compensation. The Jobs Act modified the compensation exception in § 274(e)(2), (9) to the entertainment disallowance rules to provide that the exception is not available to "specified individuals" (except to the extent of the amount of the taxable fringe benefit reported to the specified individual).

For example, suppose a flight is provided to a specified individual to go on vacation and the employer reports the value under the SIFL rate method of $1,000 to the specified individual as a taxable fringe benefit on Form W-2. Suppose further that the employer's cost of providing the flight is $5,000. The entertainment disallowance would require the employer on its federal income tax to reduce its otherwise allowable deductions for the operation of the aircraft by the difference of $4,000.

The following sections discuss the classification of flights under the post-Jobs Act entertainment disallowance and the allocation of costs to between deductible and nondeductible flights under the cost allocation rules in the proposed Treasury Regulations.[131]

1. Classification of Flights

Since the Jobs Act amendment provides that the compensation exception to the entertainment disallowance is not available for flights provided to specified individuals, employers cannot deduct the costs of flights provided as compensation to specified individuals for entertainment purposes. Therefore, employers generally must divide flights into three categories: business flights, personal nonentertainment flights and entertainment flights. These three categories of flights are described in more detail below.

a. Three Categories of Flights

(1) Business Flights

The costs of employer-provided flights for the employer's business purposes are generally deductible by the employer and should not result in a taxable fringe benefit to the employee. Business flights include only flights that are ordinary and necessary to the company's business and are not disallowed as entertainment flights as discussed above in Section II.C.1 (General Rules).

The business category includes a category identified in the proposed regulations as business entertainment.[132] Business entertainment travel refers to travel to engage in an entertainment activity if either (i) the entertainment activity is "directly related" to business, or (ii) the entertainment activity is "associated with" business and occurs immediately preceding or following a substantial business discussion. See Section II.C.1.b (Business Entertainment) above. It is generally difficult to meet these tests when the primary purpose of the trip is to engage in an entertainment activity,

but with good documentation of the business matters discussed at the event it is possible for such a flight to qualify as business entertainment.

(2) Personal Nonentertainment Flights

The Jobs Act amendment to the entertainment disallowance does not affect the employer's ability to deduct the costs of nonentertainment personal flights provided to an employee as compensation.[133] The value of such flights would be reported to the employee as a taxable fringe benefit, ordinarily at SIFL rates. This category of flights includes flights provided as compensation to specified individuals for nonentertainment personal purposes. This deductible category also includes all flights (entertainment and nonentertainment) provided as compensation to individuals other than specified individuals.

Personal nonentertainment flights are flights that do not qualify as business flights but are not for an entertainment purpose. The distinction between business and personal flights is discussed above in Section II.C.1 (Ordinary and Necessary Business Expenses). This discussion above in Section II.C.1 covers the distinction between business and entertainment flights in Section II.C.1.b. (Business Entertainment). However, the Treasury Regulations and case law distinguishing business from entertainment are only marginally helpful in distinguishing personal nonentertainment from personal entertainment.

As explained above in Section II.C.1.b(1) (Definition of Entertainment), entertainment activities are those ordinarily considered to constitute entertainment, amusement or recreation. Examples from the Treasury Regulations include entertaining at night clubs, cocktail lounges, theaters, country clubs, golf and athletic clubs, sporting events, and on hunting, fishing, vacation and similar trips. Examples from court decisions include sailing, sightseeing, parties and luncheons at the Kentucky Derby, attending the Superbowl, staying at beachfront property and parties at the taxpayer's home. The determination should be made based on the principal character of the trip, using an objective standard and taking into consideration the business of the taxpayer.

Treas. Reg. § 1.274-2(b)(1) provides some guidance in distinguishing between personal nonentertainment activities and personal entertainment activities by pointing out that "routine personal activities" would not be entertainment activities. The regulation provides the example of commuting to and from work. The preamble to the proposed regulations provides as additional examples of personal nonentertainment activities "attending to business other than that of the employer, medical purposes, attending funerals and participating in charitable activities."[134] The IRS also has provided as examples of nonentertainment activities visiting sick relatives and going to the grocery store.[135]

Based on the above guidance, several other activities that would appear to ordinarily be nonentertainment activities would include personal investment activities, meetings with legal or accounting advisors and taking a child to boarding school or college. Travel between a taxpayer's residences would appear to generally be nonentertainment travel for the same reasons that commuting is nonentertainment, unless the trip is to a second residence specifically to engage in some particular entertainment activity. Whether travel to visit relatives who are not sick is entertainment may depend on the activities undertaken on the particular trip. Visiting relatives to play golf probably would be entertainment, but visiting relatives to discuss some particular family issue would not appear to be entertainment.

To distinguish between business and entertainment, an objective test is applied taking into consideration the taxpayer's occupation. To distinguish between personal entertainment and personal nonentertainment, it would seem reasonable to take into account other objective factors that would bear on the issue of what a person would ordinarily consider to be entertainment, amusement or recreation. For example, age, sex and wealth might be reasonable considerations to take into account in determining whether going to a restaurant or going to a particular location to shop for clothes are entertainment activities.

As discussed above in Section II.C.1.b(3) (Clear Business Setting; Entertainment Presumptions), the distinction between business and entertainment is presumed one way or the other by the presence of a clear business setting or substantial distractions. It would seem reasonable to apply similar concepts with respect to the distinction between personal nonentertainment and personal entertainment. For example, visiting with relatives in their home may be a routine personal activity while visiting with them in a beachfront rental property may be an entertainment activity. In both cases, the determination based on the circumstances would seem to be more appropriate as a presumption than a final conclusion.

(3) Entertainment Flights

Beginning with the October 23, 2004, effective date of the Jobs Act, the cost of entertainment flights provided by an employer to a specified individual are not deductible. The value of such flights must be reported to the employee as a taxable fringe benefit, ordinarily at SIFL rates. The preceding section provides the definition of entertainment along with examples provided under existing law.

It appears that entertainment flights can be divided between those provided as compensation and those not provided as compensation. The Jobs Act amendment provided that the compensation exception in § 274(e)(2) to the entertainment disallowance is not available for specified individuals. Accordingly, this change in the law, including the specified individual classification, would only be relevant to flights that otherwise would fall under the compensation exception. The pre-existing general entertainment disallowance would apply to entertainment flights that are not provided as compensation irrespective of the Jobs Act and

irrespective of whether the recipient is a specified individual. For example, a flight provided to entertain customers or suppliers could not qualify for the compensation exception (assuming the customers and suppliers are not being compensated for services). Therefore, such a flight would be subject to the entertainment disallowance notwithstanding the fact that the passengers are not specified individuals. This distinction arguably creates a fourth category of flights, since these noncompensatory flights may not be subject to the passenger-by-passenger cost allocation rules described below in Section III.B.2 (Allocation of Costs).

Similarly, the costs of flights that constitute dividends or excessive compensation would be nondeductible without regard to the entertainment disallowance or the specified individual status of the passengers.[136] Therefore, such flights would not appear to be subject to the passenger-by-passenger cost allocation rules in the proposed regulations.

b. Specified Individuals

The term "specified individual" is defined as any individual who is subject to § 16(a) of the Securities Exchange Act of 1934 with respect to the company, or any individual who would be subject to it if the company were an issuer of equity securities subject to the Securities Act. IRC § 274(e)(2)(B); Prop. Treas. Reg. § 1.274-9(b). Under these rules, specified individuals generally include officers, directors and 10 percent owners.[137] Officers are defined by reference to securities laws and include the principal financial officer, principal accounting officer or controller, vice presidents in charge of a principal business unit, division or function and any other officer who performs a similar policy-making function.[138]

c. Spouse, Family and Personal Guests

A flight provided to a guest or family member of a specified individual because of the relationship to the specified individual is considered provided to the specified individual for purposes of the entertainment disallowance.[139]

As discussed above in Section II.C.2.a (Classification of Flights by Spouse, Family and Personal Guests), travel by the spouse of an employee is generally not deductible as a business expense, when the spouse's only business function is to greet and socialize. Therefore, it is usually necessary to report a taxable fringe benefit to the employee with respect to a nonemployee spouse. However, in the rare instances in which there is a bona fide business purpose for the spouse's presence on the trip, it is not necessary to report the value of the spouse's travel as a fringe benefit.

If the spouse's travel does not meet the bona fide business expense standard and therefore the value of the flight is reported to the employee, it is necessary for the employer to consider whether the spouse is traveling for entertainment or nonentertainment purposes under the standards described above. If the spouse does not engage primarily in activities that would ordinarily constitute entertainment, amusement or recreation, then it should be appropriate to classify the spouse's flight as personal nonentertainment travel.

As explained above in Section II.C.2.c (Travel Deduction Limitation Under § 274(m)(3)), the employer's deduction typically will not be affected by the deduction limitation in IRC § 274(m)(3) on travel by spouses, dependents and personal guests.

d. Security Concerns

As noted above in Section II.E.3.a (Business-Oriented Security Concerns), when there is a bona fide business-oriented security concern and certain other requirements are met, the amount of the taxable fringe benefit to the employee for personal flights is calculated with a 200 percent cap on the aircraft multiple. No similar rule has been adopted to reduce the entertainment disallowance for an aircraft. The proposed regulations indicate that the IRS is not predisposed to issue such rules, but they do not definitively state that a reduction in the entertainment disallowance is precluded in situations in which the additional cost of flying on a private aircraft is incurred for security reasons.[140] Accordingly, it would likely be difficult to convince the IRS to permit the deduction of otherwise disallowed costs of entertainment travel on the grounds that the additional travel expenses attributable to the private aircraft are incurred for security reasons.

2. Allocation of Costs

a. Allocation Methods

In the past, costs were allocated among flights in proportion to the number of miles or hours of the flight based on the primary purpose of each flight (without allocating costs of a flight among the passengers who may be traveling for different purposes).[141] As noted above in Section III.A.3 (Allocation of Costs – Primary Purpose Method), the primary purpose method appears to remain applicable to sole proprietors. While the primary purpose method remains generally applicable to a company's flights, the IRS has issued proposed regulations explaining that to allocate costs to determine the entertainment disallowance, companies must use either the "occupied seat method" or the "flight by flight" method.[142] Both of these allocation methods allocate costs based on each passenger's purpose for traveling.

Both of these passenger-by-passenger allocation methods apply only to flights that fail to qualify for the compensation exception to the entertainment disallowance due to the Jobs Act amendment. IRC § 274(e)(2), (9), as amended by the Jobs Act, provides that the compensation exception is not available to specified individuals (except to the extent of the amount reported as income to them or received from them as reimbursements). Therefore, the passenger-by-passenger allocation methods appear to apply to flights provided as compensation to specified individuals traveling for entertainment.

The primary purpose method would continue to apply to determine the entertainment disallowance for entertain-

ment flights not provided as compensation, irrespective of whether or not the recipient of the flight is a specified individual. For example, a company could not deduct the costs allocated under the primary purpose method to a flight solely to transport customers to an entertainment event (assuming the "directly related" and "associated with" tests described above in Section II.C.1.b(1) (Business Entertainment) are not met).

The two passenger-by-passenger allocation methods are described below. Appendix 1 provides an example of these calculation methods from the proposed regulations with step-by-step instructions. Under both methods, the calculation may be performed in either hours or miles. For convenience only, the explanations below of the methods refer only to hours. In addition, the references in the explanations below to specified individuals include their family and personal guests traveling on the flight.

Each year, the company may select either method and may use either miles or hours. As a result, companies typically perform the calculation four different ways (under both methods and both miles and hours) and use the result that produces the lowest entertainment disallowance amount.

As a practical matter, companies typically perform this calculation using a spreadsheet or other computer software. They often rearrange the order of the steps in these calculations to determine the entertainment use percentages under the four methods. The lowest entertainment use percentage can then be multiplied by total costs, and the SIFL amount for entertainment flights of specified individuals and their guests can then be subtracted from the result to determine the net disallowed entertainment expense.

(1) Occupied Seat Method

In general, under the occupied seat method, the company must determine the total number of occupied seat hours (or miles) flown for the year. The occupied seat hours for any particular flight are the number of hours for the flight multiplied by the number of passengers on the flight. The cost per occupied seat hour is calculated by dividing the total annual operating costs by the total number of occupied seat hours for the year. For each specified individual on each flight, the cost per occupied seat hour is multiplied by the number of hours flown by the specified individual and guests for entertainment. This entertainment cost for each specified individual for each flight is then reduced by any amounts reported as taxable fringe benefits or received as payment for the flight (e.g., time-sharing payments) to determine the net entertainment cost for the specified individual for the flight. These net entertainment costs for each specified individual on each flight are then added together to determine the total entertainment disallowance for the year.

(2) Flight-by-Flight Method

In general, under the flight-by-flight method, the company must determine the total number of hours (or miles) flown for the year. The cost for each flight is calculated by multiplying the total annual operating costs for the year by the ratio of hours for the flight over total hours flown during the year. For each flight with a specified individual (or guest) traveling for entertainment, the cost of the particular flight is divided by the total number of passengers on the flight, and the result is multiplied by the number of specified individuals and their guests traveling for entertainment purposes. This amount is then reduced by any amounts reported as taxable fringe benefits or received as reimbursement with respect to the specified individual or guest for the flight (e.g., time-sharing payments) to determine the net entertainment cost subject to the entertainment expense disallowance for the flight. These net entertainment costs for each specified individual on each flight are then added together to determine the total entertainment disallowance for the year.

b. Multi-Leg Flights

When a trip consists of multiple segments and fewer than all of the segments are for entertainment purposes, only the marginal hours (or miles) attributable to the entertainment travel are counted as entertainment.[143] For example, suppose an individual travels from City A to City B for business, from City B to City C for entertainment, and returns to City A. In that case, the flight from City A to City B would of course be treated as business. In addition, an equal number of miles (or hours) would be treated as business miles for a hypothetical return trip from City B directly back to City A. The entertainment hours (or miles) would be the excess of the actual hours (or miles) flown from City B to City C and from City C to City A over the number of hours (or miles) in the hypothetical business flight from City B back to City A.

This special rule for multi-leg flights is generally favorable to the company since it tends to minimize the number of hours (or miles) treated as entertainment. However, it has the disadvantage of requiring more administrative work.

This rule is similar to the multi-leg rule for SIFL flights discussed above in Section II.E.2.a(2) (Multi-Leg Flights), except that the SIFL rule requires a determination that the primary purpose of the multi-leg flight is business or personal. In contrast, the multi-leg flight rule for purposes of the entertainment disallowance effectively assumes that the trip is primarily for business and only treats as entertainment the marginal hours (or miles) incurred to travel to the entertainment destination.

c. Deadhead Flights

A deadhead flight is a flight with no passengers to reposition the aircraft after dropping off passengers or to pick up passengers. For purposes of the entertainment disallowance rules, a deadhead flight is treated as having the same number of passengers traveling for the same purposes as the occupied flight to which the deadhead flight relates.[144] Therefore, when there is one occupied flight from the aircraft's base to another location and a second deadhead return flight, the deadhead return flight ordinarily will be

treated as having the same number of passengers traveling for the same purposes as the first flight. This treatment of deadhead flights contrasts with the SIFL rules which provide that no SIFL income inclusion is required for a deadhead flight, as explained above in Section II.E.2.a(3) (Deadhead Flights).

Identifying the occupied flight to which a deadhead flight relates is more difficult in the case of a multi-leg trip with one or more deadhead segments. The proposed regulations state that the character of the deadhead flight should be "based on" the two occupied flights. Apparently, this leaves room for reasonable methods to be applied in determining the number and character of passengers on the deadhead flight. For example, it may be appropriate in various circumstances to base the number and character of passengers on the deadhead leg on any of the following: the number of passengers on the occupied leg representing the primary purpose for the trip; an average of the numbers of entertainment and nonentertainment passengers on the occupied legs (weighted or not weighted for the number of miles on the occupied flights); or the detour method, which is explained below and is based on the multi-leg flight rule discussed above in Section III.B.2.b (Multi-Leg Flights).

When there is a business flight, an entertainment flight and a deadhead flight, the detour method would call for the entertainment flight and the deadhead flight to be analyzed together as a hypothetical business flight to return from the actual business flight with a detour for entertainment purposes. Under this method, the total number of miles (or hours) on the deadhead and entertainment flights combined would be classified as business miles (or hours) to the extent of the number of miles (or hours) on the Business Leg, with the remaining miles (or hours) classified as entertainment. The hypothetical business flight would have the same number of passengers traveling for the same purposes as on the actual business flight. The excess miles (or hours) classified as entertainment would have the same number of passengers traveling for the same purposes as the actual entertainment flight.

d. Aggregation of Aircraft

The cost allocation methods can be applied to each aircraft separately or to the aggregate miles (or hours) of a group of aircraft having "similar cost profiles."[145] Aggregating the cost allocations for multiple aircraft may be beneficial, particularly if the specified individuals and their guests use the newest aircraft with the greatest depreciation deductions for their entertainment flights. When aircraft are not aggregated, it is necessary to allocate the costs of operating the aircraft among each aircraft to apply the cost allocation rules separately to each aircraft.

Aircraft have similar cost profiles if their operating costs per hour or per mile are comparable. To be aggregated, the aircraft must have the same engine type (jet or propeller) and have the same number of engines. Other factors that may be considered include payload, passenger capacity, fuel consumption rate, age, maintenance costs, and depreciable basis.

C. RECORDKEEPING

Adequate documentation with respect to each business and personal nonentertainment flight is critical to support the company's ability to deduct the costs of the flights. The importance of maintaining adequate documentation on a contemporaneous basis with respect to business flights is explained above in Section II.C.3 (Recordkeeping). These substantiation rules would presumably require the same level of documentation regarding the nonentertainment character of the passengers' activities on personal nonentertainment flights. Since the entertainment disallowance rules apply on a passenger-by-passenger basis, it is important to record this information with respect to each passenger.

It is often difficult for company staff to obtain detailed information from passengers regarding the nature of their personal nonentertainment activities. Nevertheless, the accounting records should include as much detail as possible regarding the passengers' nonentertainment activities for any flights classified as personal nonentertainment travel. It may also be helpful for the records to affirmatively state that the passengers did not engage in entertainment activities like hunting, fishing or attending sporting events.

D. LEASING AND CHARTERING AIRCRAFT

Private aircraft are owned and operated in a variety of arrangements. An aircraft could be leased or chartered from an owner entity to a commonly owned operating company that provides the use of the aircraft to employees. The aircraft could be leased by a company to its individual owner, who separately hires the crew to fly the aircraft. An operating company could provide the use of its aircraft to its employees under a charter arrangement or a time-sharing agreement. Alternatively, the company could place its aircraft with a charter operator to provide charter service to employees of the company and to third parties. In each of these cases, the company may need to address the question of whether and how to apply the entertainment disallowance to an aircraft that is leased or chartered to another party.

1. Adequate and Full Consideration Exception

Much of the discussion above regarding the entertainment disallowance focuses on the compensation exception in IRC § 274(e)(2), (9). However, companies leasing or chartering their aircraft to others may be able to apply the adequate and full consideration exception in § 274(e)(8) to avoid any entertainment disallowance of the employer's costs. To apply this exception, it is essential that the lease or charter be at arm's length rates and terms. When the aircraft is leased or chartered to unrelated third parties, it would ordinarily be the case that the rate charged would be respected as a fair market charter rate and the adequate

and full consideration exception would apply to the lessor or charter company.[146]

In the case of leases or charters to related parties, if the lease or charter is at arm's length rates and terms, then the adequate and full consideration exception ordinarily should apply to prevent the entertainment disallowance from applying to the lessor or charter company.[147] However, the IRS is likely to scrutinize such transactions carefully.[148] Moreover, the discussion of the adequate and full consideration exception in the preamble to the proposed regulations suggests that the IRS intends to interpret the adequate and full consideration exception narrowly.[149]

Whether time-sharing arrangements will fall within the adequate and full consideration exception is unclear. Since time-sharing rates are typically below fair market charter rates, it would seem unlikely that time-sharing payments would be sufficient to invoke the adequate and full consideration exception. Nevertheless, some taxpayers argue that the time-sharing lessor is charging the maximum rate allowed by law.

2. Special Allocation Rule for Third-Party Leases and Charters

When an aircraft is leased or chartered to third parties, it may be difficult to obtain information regarding the number of passengers on each flight or their purposes for traveling. In recognition of this difficulty, the proposed regulations provide that when an aircraft is leased or chartered to unrelated third parties for adequate and full consideration, expenses allocable to the lease or charter are excluded from the entertainment disallowance calculation.[150] Presumably, the miles and hours involved in the lease or charter would also be excluded from those calculations.

Since the preamble to the proposed regulations makes it clear that the proposed regulations do not address the adequate and full consideration exception, this exception should not be interpreted to mean that the adequate and full consideration exception is only applicable to leases or charters to unrelated third parties.

E. COSTS SUBJECT TO ENTERTAINMENT DISALLOWANCE

The costs subject to the entertainment disallowance calculation include all out-of-pocket expenses of the flights and all costs with respect to the aircraft. These would include all fixed and variable costs of operating the aircraft.[151] The proposed regulations list the following examples of expenses subject to the disallowance: salaries for pilots, maintenance personnel and other personnel assigned to the aircraft; meal and lodging expenses for the flight personnel; take-off and landing fees; costs for maintenance flights; costs of on-board refreshments, amenities and gifts; hangar fees (at home or away); management fees; costs of fuel, tires, maintenance, insurance, registration, certification of title, inspection and depreciation; and all costs paid or incurred for aircraft leased or chartered to or by the taxpayer.

1. Overhead and Tax Preparation

While the list of costs seems long, it is important to note that all of these costs relate directly to the aircraft. The list of examples from the proposed regulations as well as guidance from existing regulations do not appear to contemplate the allocation of corporate overhead or other indirect costs to an aircraft operation.[152] For example, it would not appear appropriate to include a percentage of the costs of the company's human resources and payroll departments allocable to hiring and paying the pilots. Furthermore, costs relating to tax return preparation, such as the costs of calculating the entertainment disallowance, should not be subject to the entertainment disallowance.

2. Maintenance Flights

The list of costs subject to the disallowance includes the cost of maintenance flights. This seems consistent with the occupied seat method, which only considers flights with occupied seats and related deadhead flights. Since a maintenance flight would not be included in either the numerator or denominator of the occupied seat method calculation, the cost of the maintenance flight would effectively be included in the costs allocated between entertainment and nonentertainment flights under the occupied seat method. In fact, under the occupied seat method, the costs of training flights and any other flights for purposes other than transporting passengers would effectively be allocated between entertainment and nonentertainment flights.

The treatment of maintenance and training flights is less clear under the flight-by-flight method. The denominator under the flight-by-flight method is the total hours (or miles) flown for the year.[153] Therefore, it can be argued that maintenance and training flights are included in the denominator in the allocation of expenses, thus reducing the amount subject to the disallowance. Courts interpreting similar allocation ratios have reached different results on this issue suggesting that it is an open question whether the denominator of the allocation ratios under the flight-by-flight method should include the hours (or miles) flown for maintenance and training flights.[154]

3. Straightline Election for Depreciation

Accelerated depreciation and bonus depreciation were enacted by Congress to encourage investment in depreciable property. The concern was raised with Treasury that this goal of encouraging investment may be thwarted by the entertainment disallowance rules which would disallow a portion of these enhanced depreciation deductions. In response to this concern, the proposed regulations permit companies to elect to calculate the entertainment disallowance amount using a depreciation amount calculated under the straight-line method over the alternative depreciation life of the aircraft.[155] If a company elects this method, only the straight-line depreciation amount will be included in

the disallowance calculation, but all of the depreciation in excess of the straight-line amount will be fully deductible.

This straight line depreciation election can produce a significant timing benefit. However, companies should be careful about making this election for several reasons. First, the election would preclude a company from taking advantage of the strategy of deducting bonus depreciation in the year of acquisition and eliminating personal use of the aircraft in that year to maximize the amount of depreciation that escapes disallowance. Second, once the depreciation election is made it can only be revoked with IRS permission pursuant to a private letter ruling as long as the company provides the use of aircraft to its employees. Third, the transition rule as stated in the proposed regulations provides that the straight-line depreciation amount for the year of the election is determined as if straight-line depreciation had been used in all prior years for the aircraft. By failing to make this adjustment prospectively, the transition rule causes more than 100 percent of the adjusted basis of the aircraft to be subject to the entertainment disallowance calculation. (Presumably, this defective transition rule was an oversight in drafting the proposed regulations that will be corrected in the final regulations.)

4. Interest Expense

The examples of expenses included in the cost disallowance calculation do not include interest expense.[156] Interest was also omitted from the list of costs subject to disallowance in IRS Notice 2005-45, 2005-1 C.B. 1228, § B(4), which predated the proposed regulations. In addition, interest is also omitted from the existing regulations regarding the entertainment disallowance.[157] Furthermore, existing rulings omit any reference to interest as subject to the entertainment disallowance.[158]

Since interest expense is a major component of the cost of an aircraft and the drafters of the proposed regulations were well aware of the issue of whether interest was an includible cost, it seems clear that the omission of interest from the list of examples of includible expenses was intentional. In view of the existing guidance on the issue, it seems reasonable to conclude that the intentional omission of interest from the list of expenses subject to the disallowance means that interest expense does not have to be included in the disallowance calculation. However, an alternative explanation for the absence of interest is that the drafters of the proposed regulations have not developed a method of identifying which debt is to be considered allocable to the aircraft, and they have refrained from listing interest as an includible expense for that reason. Since the tax court in *Helwig v. Commissioner,* T.C. Memo (RIA) 1999-386, apparently accepted the parties' consensus that interest expense is subject to the entertainment disallowance, companies should be cautious about excluding interest from the costs subject to the entertainment disallowance.

F. OTHER DEDUCTION LIMITATIONS

1. Publicly Held Corporations

Publicly held corporations are subject to an expense disallowance rule under IRC § 162(m) which precludes compensation deductions in excess of $1 million for the CEO and the other four highest paid employees. There are exceptions such as for commission-based or performance-based compensation. When a covered employee's compensation exceeds the $1 million cap, the employer cannot deduct the cost of nonbusiness flights provided to the covered employee.

In the case of a covered employee's entertainment flights, the company would otherwise be able to deduct only the amount that it reported to the employee as a taxable fringe benefit, ordinarily at SIFL rates. The application of the § 162(m) limitation takes away the company's ability to deduct the costs in the amount of this fringe benefit.[159]

In the case of a covered employee's personal nonentertainment flights, the company would otherwise be able to deduct the full amount of the cost of the flight. Since § 162(m) applies to the deduction of compensation, it appears that the § 162(m) disallowance prevents the company from deducting the cost of the flight in the amount of the reported fringe benefit. However, the costs of the flight in excess of this amount may still be deductible by the company.

2. Foreign Travel

As explained above in Section II.E.3.b (Foreign Travel), the foreign travel disallowance rule in IRC § 274(c) should not affect an employer's ability to deduct costs with respect to a foreign trip. It could only require the reporting of imputed income to an employee who engages primarily in personal activities on at least 25 percent of the days on a foreign trip lasting more than one week. However, this rule could result in the disallowance of deductions for sole proprietors, who should refer to Section II.E.5.b (Foreign Travel) above for more information regarding this provision. Nothing in the foreign travel rules or the entertainment disallowance rules suggests that the foreign travel rules trigger the disallowance of expenses under the entertainment disallowance.

3. 50 Percent Entertainment Disallowance

IRC § 274(n)(1) imposes a 50 percent disallowance on the deduction of entertainment expenses. This would seem superfluous in view of the 100 percent disallowance in § 274(a), except that the 50 percent disallowance in § 274(n)(1) does not provide an exception for entertainment activities meeting the "directly related" or "associated with" tests described above in Section II.C.1.b (Business Entertainment). Therefore, the 50 percent disallowance would appear to apply to business entertainment expenses. While this 50 percent entertainment disallowance may generally apply to business entertainment expenses, the legislative history to the Tax Reform Act of 1986 clarifies that it does not apply to travel expenses.[160] This indicates that the 50 percent disallowance should not apply to business entertainment flights.

4. Entertainment Facility

There is some risk that aircraft are subject to an additional expense disallowance under the prohibition on deducting expenses with respect to entertainment *facilities*.[161] Treasury Regulations provide that expenditures with respect to an aircraft are deemed business travel rather than expenses with respect to an entertainment facility to the extent that the aircraft is used in pursuit of a trade or business and not for entertainment.[162] That regulation cross references another section of the regulations with respect to nonentertainment use of an entertainment facility, which more generally provides that the entertainment facility disallowance does not apply to "[e]xpenses or items attributable to the use of a facility for other than entertainment purposes such as expenses for an automobile when not used for entertainment."[163] This provision suggests that personal nonentertainment flights should not be subject to the entertainment facility disallowance.

However, the preamble to the proposed regulations states that the IRS believes that the entertainment facility disallowance should apply to personal nonentertainment flights.[164] This statement appears to be based solely on the wording of IRC § 274(a)(1)(B), without considering the legislative history and existing regulations referenced above. Furthermore, the preamble states that, in passing the Jobs Act, Congress did not consider the effect of the amendment to IRC § 274(e)(2) on the entertainment facility disallowance. The preamble requests comments on whether final regulations should address the entertainment facility issue.

Further complicating the matter is the question of whether an aircraft should be classified as an entertainment facility at all. Treasury Regulations state that aircraft and automobiles are the types of assets that may be entertainment facilities.[165] Existing case law indicates that any use of a facility for entertainment during the year makes it an entertainment facility.[166] However, the Tax Court in *Sutherland Lumber-Southwest, Inc. v. Commissioner*, 114 T.C. 197, 202 n.3 (2000), *aff'd*, 255 F.3d 495 (8th Cir. 2001), *acq*. 2002-1 C.B. xvii., raised the question in a footnote of whether an aircraft is an entertainment facility.

In view of the ambiguous state of the guidance regarding the applicability of the entertainment facility disallowance to aircraft, most companies are currently applying only the entertainment expense disallowance set forth in Prop. Treas. Reg. §§ 1.274-9, -10 and are not disallowing additional deductions under the entertainment facility disallowance.

5. Charitable Flights

Surprisingly, flights for exclusively charitable purposes result in significant adverse tax consequences. Charitable flights are generally not considered entertainment flights, as explained above in Section III.B.1.a(2) (Personal Nonentertainment Flights). However, the tax problem with charitable flights does not arise from the entertainment disallowance. It arises from the fact that a charitable flight that is not related to the business of the taxpayer does not support a business deduction for the costs attributable to the flight. Furthermore, a charitable deduction is only allowed for the out-of-pocket costs of the flight (such as fuel).[167] As a result, fixed costs allocable to the flight (e.g., depreciation, hangar rental, regular maintenance, salaries and insurance) are not deductible as either business expenses or charitable contributions.[168]

It is possible that a company may determine that flights in connection with a charitable activity are deductible as a business expense, depending on the particular facts and circumstances. For example, participation in a charitable activity may qualify as institutional or goodwill advertising by keeping the company's name before the public.[169]

Another possibility would be to treat the charitable flight as a personal activity of a particular employee and report the SIFL value of the flight as a taxable fringe benefit to that employee. The employer would deduct the entire cost of the flight as a compensation expense, since it would be a personal nonentertainment flight. The employee would have to report the SIFL amount as additional taxable income, but, at least in the aggregate, this is a less adverse tax result than having the fixed costs attributable to the charitable flight disallowed.

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Founded in 1947 and based in Washington, DC, the National Business Aviation Association (NBAA) is the leading organization for companies that rely on general aviation aircraft to help make their businesses more efficient, productive and successful.

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Appendix 1: Sample Calculations

EXAMPLE OF COST ALLOCATION

The following is an example of the occupied seat method and flight-by-flight method for allocating costs to entertainment flights for purposes of the entertainment disallowance under the proposed regulations.

This example modifies the order of the steps described in the proposed regulations. In the calculations below, entertainment percentages are calculated under the two methods using miles and hours. The lowest entertainment percentage is multiplied by the operating costs for the year to determine the costs allocable to entertainment flights. The imputed income at SIFL rates and the reimbursements with respect to entertainment flights are subtracted to determine the entertainment disallowance to report on the employer's income tax return.

This example involves an employer-provided aircraft. The aircraft operating costs including depreciation for the year total $1,000,000. There are only the following four flights on the aircraft during the year:

Flight 1 – Business Flight

St. Louis to Chicago – 251 mi., 0.7 hours, six passengers

- Six passengers traveling for business

Chicago to St. Louis – 251 mi., 0.7 hours, six passengers

- Six passengers returning from business trip

Flight 2 – Entertainment Flight

St. Louis to Orlando – 874 mi., 2.1 hours, four passengers

- Specified individual and three personal guests traveling for entertainment

Orlando to St. Louis – 874 mi., 2.1 hours, four passengers

- Four passengers returning from entertainment trip

Time-sharing reimbursement received from specified individual	$2,520
Imputed income at SIFL rates, before subtracting reimbursement	$4,694
Less: Time-sharing reimbursement	(2,520)
Imputed income reported to specified individual (net of reimbursement)	$2,174

Flight 3 – Personal Nonentertainment Flight

St. Louis to Wichita – 378 mi., 0.9 hours, two passengers

- Specified individual and personal guest traveling for personal nonentertainment purposes

Wichita to St. Louis – 378 mi., 0.9 hours, two passengers

- Two passengers returning from personal nonentertainment trip

Imputed income to specified individual at SIFL rates:	$1,218

Flight 4 – Mixed Business and Entertainment Flight

St. Louis to New York – 895 mi., 2.1 hours, four passengers

- Two specified individuals traveling for business, with their spouses traveling for entertainment purposes

New York to St. Louis – 895 mi., 2.1 hours, four passengers

- Four passengers returning from business/entertainment trip

Total imputed income to specified individuals at SIFL rates:	$2,392

(See next page for cost disallowance worksheet)

COST DISALLOWANCE WORKSHEET

							Occupied Seat Method				Flight-by-Flight	
Flight	Miles	Hours	Total Pax	Bus. Pax	Pers. NonE Pax	Enter. Pax	Total O/S Miles	Enter. O/S Miles	Total O/S Hours	Enter. O/S Hours	Enter. Miles	Enter. Hours
1	251	0.7	6	6			1,506		4.2			0
1	251	0.7	6	6			1,506		4.2			0
2	874	2.1	4			4	3,496	3,496	8.4	8.4	874	2.1
2	874	2.1	4			4	3,496	3,496	8.4	8.4	874	2.1
3	378	0.9	2		2		756		1.8			0
3	378	0.9	2		2		756		1.8			0
4	895	2.1	4	2		2	3,580	1,790	8.4	4.2	*448	*1.1
4	895	2.1	4	2		2	3,580	1,790	8.4	4.2	448	1.1
Totals	4,796	11.6					18,676	10,572	45.6	25.2	2,644	6.4
Divided by								18,676		45.6	4,796	11.6
Entertainment Percetage							56.6%		55.3%	55.1%	55.2%	
Lowest Entertainment Percentage											55.1%	

COST DISALLOWANCE CALCULATION

Total Aircraft Operating Costs	$ 1,000,000
Entertainment Percentage	× 55.1%
Costs Attributable to Entertainment Flights	551,000
Less: Reimbursements Received for Entertainment Flights – Flight 2	(2,520)
Imputed Income Reported for Entertainment Flights:	
Flight 2	(2,174)
Flight 4	(2,392)
Entertainment Disallowance	$ 543,914

* The flight-by-flight method columns present the miles and hours of each flight multiplied by the percentage of passengers on the flight traveling for entertainment purposes. For example, on Flight 4 the entertainment miles are calculated as follows: 895 total mi. × (2 entertainment pax / 4 total pax) = 448 entertainment mi.

Appendix 2:
Examples of Common Scenarios

Examples	Income Inclusion	Deduction Disallowance
Vacation flight by CEO of corporation and spouse; 1 hour	Yes. SIFL value x 2 legs (employee and spouse) in CEO's W-2	Yes. 2 seat hours
Vacation flight by non-specified individual of corporation and spouse; 1 hour	Yes. SIFL value x 2 legs (employee and spouse) in employee's W-2	No
Business flight by CEO of corporation, 2 hours; spouse accompanies for personal but not for entertainment	Yes. SIFL value x 1 leg (spouse only) in CEO's W-2	No
Business flight by CEO, 2 hours; spouse accompanies for entertainment	Yes, SIFL value x 1 leg (spouse only) in CEO's W-2	Yes. 2 seat hours
Commute by CEO/owner of LLC	Yes. SIFL value x 1 leg in CEO's K-1	No
Vacation trip by non-specified individual, non-owner employee of LLC	Yes. SIFL value x 1 leg in employee's W-2	No
10-seat plane occupied by CEO of corporation and 4 non-specified individual employees on business; with spouses for entertainment; 1 hour	No	Yes. 1 seat hour
10-seat plane occupied by CEO of corporation and 3 non-specified individual employees on business; and *4 guests of CEO* for entertainment; 1 hour	Yes. SIFL value x 4 legs (4 guests) in CEO's W-2	Yes. 4 seat hours
Vacation flight by CEO of corporation, spouse, and 3 children (1 of whom is 19 months old); 5 hours occupied trip to vacation destination, 5 hour deadhead return	Yes. SIFL value x 4 legs in CEO's W-2	Yes. 50 seat hours
Business flight by sole proprietor as primary purpose, spouse accompanies; 1 hour	No	No
Vacation flight by sole proprietor and spouse; 1 hour	No	Yes, entire cost of flight
CEO of corporation uses *his own airplane* for business flights for his work as an employee of the corporation	Only if reimbursements for use of airplane exceed actual *substantiated expenses*	No, and CEO can deduct, subject to 2 percent floor, amounts not reimbursed by corporation
Director of corporation uses *his own airplane* for business flights for his work as a director of the corporation	Only if reimbursements for use of airplane exceed actual *substantiated expenses*	No, and director can deduct amounts not reimbursed by corporation
Specified individual employee travels on employer aircraft from NY to Paris for 2 days of vacation, to London for 2 days of business meetings, return to NY (trip primarily business)	Yes. SIFL value of mileage equal to excess of NY to Paris to London to NY, over NY to London to NY	Yes, equal to excess of NY to Paris to London to NY, over NY to London to NY

IV. Endnotes

1. FAR § 91.501(b)(5).
2. FAA Chief Counsel Interpretation 1993-17 (Aug 2, 1993) (involving Charles Schwab).
3. FAR § 91.501(b)(6).
4. FAA Chief Counsel Interpretation 1989-22 (Aug. 8, 1989).
5. FAR § 61.113(c).
6. Treas. Reg. § 1.61-21(b)(1).
7. Treas. Reg. § 1.61-21(a)(3).
8. Treas. Reg. § 1.61-21(a)(4).
9. Treas. Reg. § 1.61-21(g)(11).
10. Treas. Reg. § 1.61-21(a)(4).
11. Treas. Reg. § 1.61-21(g)(1).
12. Treas. Reg. § 1.61-21(a)(5).
13. Treas. Reg. § 1.61-21(a)(1), (3).
14. Treas. Reg. § 1.61-21(g)(4)(v).
15. *See Manning v. Comm'r*, T.C. Memo (RIA) 1993-127 (whether personal use of corporate property is a constructive dividend or constructive wages is a question of fact).
16. Treas. Reg. § 1.61-21(g)(4)(v).
17. Treas. Reg. §§ 1.162-7, -8.
18. Treas. Reg. § 1.61-21(b)(7).
19. IRC § 132(a)(3).
20. IRC § 132(d).
21. Treas. Reg. § 1.61-21(b)(6), (g)(3)(ii).
22. *Noyce v. Comm'r*, 97 T.C. 670 (1991); *Marshall v. Comm'r*, T.C. Memo (RIA) 1992-65.
23. *Marshall*.
24. *See Noyce; Marshall; Kurzet v. Comm'r*, 222 F.3d 830 (10th Cir. 2000); *Richardson v. Comm'r*, T.C. Memo (RIA) 1996-368.
25. *Edwards v. Comm'r*, T.C. Memo (RIA) 2002-169.
26. *Noyce, Kurzet.*
27. Treas. Reg. § 1.162-2(b)(1); *Noyce; French v. Comm'r*, T.C. Memo (RIA) 1990-314.
28. Treas. Reg. § 1.162-2(b)(2).
29. *Finney v. Comm'r*, T.C. Memo (RIA) 1980-23; *Nemish v. Comm'r*, T.C. Memo (RIA) 1970-276, *aff'd per curiam*, 452 F.2d 611 (9th Cir. 1971).
30. *Marshall* (travel to meet with contractors by officer in charge of project); *French* (travel to rental property); *Palo Alto Town & Country Village, Inc. v. Comm'r,* 565 F.2d 1388 (9th Cir. 1977) (travel for shopping center business).
31. *Kurzet*.
32. *Richardson v. Comm'r,* T.C. Memo (RIA) 1996-368.
33. *Townsend Industries, Inc. v. United States,* 342 F.3d 890 (8th Cir. 2003) (fishing trip); *United Title Ins. Co. v. Comm'r*, T.C. Memo (RIA) 1988-38 (meetings with clients at resort).
34. *See Berkley Machine & Foundry Co. v. Comm'r,* T.C. Memo (RIA) 1983-477.
35. *See Noyce v. Comm'r,* 97 T.C. 670 (1991) (service on college board of directors); *see also* Treas. Reg. § 1.132-5(a)(2)(ii), Examples (3), (4) (service on board of charitable organization).
36. Treas. Reg. § 1.162-20(a)(2).
37. *Beckley v. Comm'r,* T.C. Memo (RIA) 1975-37.
38. Treas. Reg. § 1.162-2(d); Rev. Rul. 59-316, 1959-2 C.B. 57; Rev. Rul. 63-266, 1963-2 C.B. 88.
39. *Acacia Mutual Life Ins. Co. v. United States*, 272 F. Supp. 188 (D. Md. 1967); *Peoples Life Ins. Co. v. United States*, 373 F.2d 924 (Ct. Cl. 1967).
40. *See also Patterson v. Thomas*, 289 F.2d 108 (5th Cir. 1961), *cert. denied,* 368 U.S. 837 (1961).
41. *Love Box Co. v. Comm'r,* 842 F.2d 1213 (10th Cir. 1988), *cert. denied*, 488 U.S. 820 (1988).
42. *Danville Plywood Corp. v. United States*, 899 F.3d 3 (Fed. Cir. 1990).
43. *French v. Comm'r*, T.C. Memo (RIA) 1990-314.
44. *McReavy v. Comm'r,* T.C. Memo (RIA) 1989-172; *Leubert v. Comm'r*, T.C. Memo (RIA) 1983-457.
45. *Christine v. Comm'r*, T.C. Memo (RIA) 1974-249.
46. Treas. Reg. § 1.162-2(e); *Comm'r v. Flowers*, 326 U.S. 465 (1946).
47. Rev. Rul. 99-7, 1999-1 C.B. 361 (travel to temporary place of work); *Chandler v. Comm'r,* 226 F.2d 467 (1st Cir. 1955) (travel to secondary regular place of business).
48. *Markey v. Comm'r*, 490 F.2d 1249 (6th Cir. 1974); *Terry v. Comm'r,* T.C. Memo (RIA) 1979-284.
49. Treas. Reg. § 1.162-2(b)(2).
50. *Sherry v. Comm'r,* T.C. Memo (RIA) 1975-337.
51. *Cowing v. Comm'r,* T.C. Memo (RIA) 1969-135.
52. Rev. Rul. 59-316, 1959-2 C.B. 57; Rev. Rul. 63-266, 1963-2 C.B. 88.
53. *Acacia Mutual Life Ins. v. United States,* 272 F. Supp. 188 (D. Md. 1967).
54. *See Patterson v. Thomas*, 289 F.2d 108 (5th Cir. 1961), *cert. denied*, 368 U.S. 837 (1961); *Manning*.
55. *See Patterson; Manning*.
56. IRC § 274(a)(1)(A); Treas. Reg. § 1.274-2(a)(1).
57. Prop. Treas. Reg. § 1.274-10(b)(3).
58. Treas. Reg. § 1.274-2(b)(1).
59. *Mediaworks, Inc. v. Comm'r,* T.C. Memo (RIA) 2004-177 (sailing); *Walliser v. Comm'r*, 72 T.C. 433 (1979) (sightseeing); *Churchill Downs, Inc. v. Comm'r*, 307 F.3d 423 (6th Cir. 2002) (Kentucky Derby); *Danville Plywood Corp. v. United States,*

899 F.2d 3 (Fed. Cir. 1990) (Superbowl); *Ireland v. Comm'r*, 89 T.C. 978 (1987) (beachfront property); *Andress v. Comm'r,* 51 T.C. 863 (1969), *aff'd per curiam*, 423 F.2d 679 (5th Cir. 1970) (parties).

60. Treas. Reg. § 1.274-2(b)(1)(ii).

61. Treas. Reg. § 1.274-2(b)(1)(ii).

62. Treas. Reg. § 1.274-2(c)(3)(iii).

63. H.R. Rep. No. 87-1881, § IV, B (1962).

64. *Walliser v. Comm'r*, 72 T.C. 433 (1979) (sightseeing vacation with customers); *Andress v. Comm'r*, 51 T.C. 863 (1969), *aff'd per curiam*, 423 F.2d 679 (5th Cir. 1970) (parties at taxpayer's residence); *Danville Plywood Corp. v. United States*, 899 F.2d 3 (Fed. Cir. 1990) (Superbowl); *Manning v. Comm'r*, 1993-127 (meals and golf); *St. Petersburg Bank & Trust Co. v. United States*, 362 F. Supp. 674 (M.D. Fla. 1973) *aff'd per curiam*, 503 F.2d 1402 (5th Cir. 1974), *cert. denied*, 423 U.S. 834 (1975) (cocktail and dinner parties at taxpayer's residence).

65. Treas. Reg. § 1.274-2(c)(4).

66. Treas. Reg. § 1.274-2(c)(3)(iii).

67. Treas. Reg. § 1.274-2(c)(7).

68. IRC § 274(a)(1)(A); Treas. Reg. § 1.274-2(d).

69. Treas. Reg. § 1.274-2(d)(3)(i).

70. Treas. Reg. § 1.274-2(d)(3)(i).

71. Treas. Reg. § 1.162-2(c).

72. *Anchor National Life v. Comm'r*, 93 T.C. 382 (1989).

73. *See United States v. Gotcher*, 401 F.2d 118 (5th Cir. 1968); *Manning v. Comm'r,* T.C. Memo (RIA) 1993-127 (sightseeing and shopping); *Danville Plywood Corp. v. United States*, 899 F.2d 3 (Fed. Cir. 1990) (employees' wives "manned the hospitality desk" and entertained the spouses of the customer representatives while on the trip); *Estate of Shantz v. Comm'r*, T.C. Memo (RIA) 1983-743 (staffing a hospitality suite, serving as a hostess, assisting in social settings); *Sisson v. Comm'r*, T.C. Memo (RIA) 1994-545, *aff'd*, 108 F.3d 339 (9th Cir. 1996) ("Attending social functions arranged for guests of conference participants is not a bona fide business purpose, even though such activities may contribute to the promotion of the taxpayer's business."); *Challenge Manufacturing Co. v. Comm'r*, 37 T.C. 650 (1962), *acq.* 1962-2 C.B. 4; *Price v. Comm'r*, T.C. Memo (RIA) 1971-323; Rev. Rul. 56-168, 1956-1 C.B. 93 (typing notes or attending business luncheons and dinners).

74. *See Peoples Life Ins. Co. v. United States*, 373 F.2d 924 (Ct. Cl. 1967) (spouses participated in seminars); *Bywater Sales and Service Co. v. Comm'r,* T.C. Memo (RIA) 1965-160 (serving as a translator); *Kerr v. Comm'r*, T.C. Memo (RIA) 1990-155; *Warwick v. United States*, 236 F. Supp. 761 (E.D. Va. 1964) (entertaining and attending business tours in European and Latin America; performing clerical duties); *United States v. Disney,* 413 F.2d 783 (9th Cir. 1969) (wife of president of Walt Disney Productions was present to promote company's family image and cultivate relationships with other executives; wife attended luncheons, dinners, receptions, film screenings, press conferences and went on good will visits).

75. Treas. Reg. § 1.274-2(g).

76. Treas. Reg. § 1.274-2(b)(2)(iii).

77. *See French v. Comm'r*, T.C. Memo (RIA) 1990-34 (family members accompanied taxpayer on private aircraft); *Pohl v. Comm'r,* T.C. Memo (RIA) 1990-298 (spouse accompanied taxpayer traveling by car); *Marlin v. Comm'r*, 54 T.C. 560 (1970), *acq.* 1970-2 C.B. xx (spouse accompanied taxpayer on trip to Europe); Rev. Rul. 56-168, 1956-1 C.B. 93; IRS Pub. 463, at 5 (2008).

78. Treas. Reg. § 1.274-5T(b)(2), (6).

79. Treas. Reg. § 1.274-5T(b)(3), (4).

80. Treas. Reg. § 1.274-5T(c)(2)(i).

81. Treas. Reg. § 1.274-5T(c)(2)(ii).

82. Treas. Reg. § 1.274-5T(c)(2)(ii)(B).

83. Treas. Reg. § 1.274-5T(c)(3)(i).

84. Treas. Reg. § 1.274-5T(c)(1).

85. *See, e.g., Christian v. Comm'r*, T.C. Memo (RIA) 2000-385; *Finney v. Comm'r,* T.C. Memo (RIA) 1980-23; *Romer v. Comm'r*, T.C. Memo (RIA) 2001-168.

86. Treas. Reg. § 1.61-21(b)(6).

87. Treas. Reg. § 1.61-21(b)(6)(iii).

88. Treas. Reg. § 1.61-21(b)(7).

89. Treas. Reg. § 1.61-21(g)(2).

90. Ann. 85-113, 1985-31 I.R.B. 31; *see also* Treas. Reg. § 1.61-21(c)(7); Notice 2005-45, 2005-1 C.B. 1228, § A.

91. Treas. Reg. § 1.61-21(g)(3)(i).

92. Treas. Reg. § 1.61-21(g)(4).

93. Treas. Reg. § 1.61-21(g)(3)(iii).

94. Treas. Reg. § 1.61-21(g)(3)(i).

95. Treas. Reg. § 1.132-5(m).

96. Treas. Reg. § 1.61-21(a)(5).

97. Treas. Reg. § 1.61-21(g)(8)(ii)(B).

98. Treas. Reg. § 1.61-21(g)(8)(ii)(A).

99. Treas. Reg. § 1.61-21(g)(11).

100. Treas. Reg. § 1.61-21(g)(7).

101. Treas. Reg. § 1.61-21(g)(8)(ii)(A).

102. IRC § 267(c)(4).

103. Treas. Reg. § 1.61-21(c)(4), (g)(10).

104. Treas. Reg. § 1.61-21(g)(8)(ii)(B).

105. Treas. Reg. § 1.132-5(m)(4).

106. See Priv. Ltr. Rul. 2007-05-010 (Feb. 2, 2009).

107. Treas. Reg. § 1.132-5(m)(3)(ii).

108. Treas. Reg. § 1.132-5(m)(2)(i).

109. Treas. Reg. § 1.132-5(m)(2)(ii), (iv).

110. Treas. Reg. § 1.132-5(m)(2)(iii).

111. Treas. Reg. § 1.132-5(m)(2)(iv).

112. Treas. Reg. § 1.132-5(m)(4).

113. Treas. Reg. § 1.274-4(f)(1).

114. Treas. Reg. § 1.274-4(d)(2)(i).

115. Treas. Reg. § 1.274-4(d)(2)(ii).

116. Treas. Reg. § 1.274-4(d)(2)(v).

117. Treas. Reg. § 1.61-21(g)(4)(iv).

118. IRC § 274(h).

119. Treas. Reg. § 1.61-21(g)(12)(i)(A).

120. Treas. Reg. § 1.61-21(g)(12)(iii)(A).

121. Treas. Reg. § 1.61-21(g)(12)(iii)(B).

122. Treas. Reg. § 1.61-21(g)(12)(v).

123. Treas. Reg. § 1.61-21(g)(12)(i).

124. Treas. Reg. § 1.61-21(g)(14).

125. Prop. Treas. Reg. § 1.61-21(g)(14)(iii).

126. Treas. Reg. § 1.61-21(c)(5), (g)(13).

127. See Treas. Reg. § 1.162-25T.

128. *See, e.g., Noyce v. Comm'r*, 97 T.C. 670 (1991).

129. Treas. Reg. § 1.162-2(b).

130. *Noyce v. Comm'r*, 97 T.C. 670 (1991).

131. Prop. Treas. Reg. §§ 1.274-9, -10.

132. Prop. Treas. Reg. § 1.274-10(b)(3).

133. IRC § 274(e)(2); Prop. Treas. Reg. § 1.274-10(a).

134. Preamble to Prop. Treas. Reg. §§ 1.274-9, -10, § 1(a), 72 Fed. Reg. 33,169, 33,171 (June 15, 2007).

135. Rev. Rul. 63-144, 1963-2 C.B. 129, Q&A 10, 76.

136. Treas. Reg. § 1.274-2(f)(2)(iii)(C), Example.

137. Exchange Act Rule 16a-2.

138. Exchange Act Rule 16a-1(f).

139. Prop. Treas. Reg. § 1.274-9(b)(6).

140. Prop. Treas. Reg. § 1.274-10(b)(3); *see also* Preamble to Prop. Treas. Reg. §§ 1.274-9, -10, § 1(c), 72 Fed. Reg. 33,169, 33,171 (June 15, 2007).

141. *See, e.g., Noyce v. Comm'r,* 97 T.C. 670 (1991); *Sutherland Lumber-Southwest, Inc. v. Comm'r*, 114 T.C. 197 (2000), *aff'd*, 255 F.3d 495 (8th Cir. 2001), *acq*. 2002-1 C.B. xvii; Temp. Treas. Reg. § 1.274-5T(b)(6)(i)(B).

142. Prop. Treas. Reg. § 1.274-10(e).

143. Prop. Treas. Reg. § 1.274-10(e)(2)(iii).

144. Prop. Treas. Reg. § 1.274-10(f)(3).

145. Prop. Treas. Reg. § 1.274-10(d)(4).

146. See Prop. Treas. Reg. § 1.274-10(d)(2).

147. *See* Tech. Adv. Mem. 2002-14-007 (§ 274(e)(8) applied to company that provided use of facility to related company, based in part on fact that company was paid fair value for the use of the facility); Rev. Rul. 63-144, 1963-2 C.B. 129, Q&A 52, 53 (lessor not subject to entertainment facility disallowance on lease to related party with fair market rental rate and terms); *Catalano v. Comm'r,* T.C. Memo (RIA) 1998-447, *aff'd*, 240 F.3d 842 (9th Cir. 2001) (individual lessor and wholly-owned S corporation lessee were respected as separate taxpayers for purposes of entertainment disallowance).

148. See Rev. Rul. 63-144, 1963-2 C.B. 129, Q&A 53; *International Artists, Ltd. v. Comm'r*, 55 T.C. 94 (1970).

149. Preamble to Prop. Treas. Reg. §§ 1.274-9, -10, § 5(i), 72 Fed. Reg. 33,169, 33,173 (June 15, 2007).

150. Prop. Treas. Reg. § 1.274-10(d)(2).

151. Prop. Treas. Reg. § 1.274-10(d)(1).

152. Treas. Reg. § 1.274-2(e)(3)(i).

153. Prop. Treas. Reg. § 1.274-10(e)(3)(ii).

154. *See, e.g., Noyce v. Comm'r*, 97 T.C. 670 (1991) (maintenance flights included in denominator).

155. Prop. Treas. Reg. § 1.274-10(d)(3).

156. Prop. Treas. Reg. § 1.274-10(d)(1).

157. Treas. Reg. § 1.274-2(e)(3)(i).

158. Rev. Rul. 63-144, 1963-2 C.B. 129, Q&A 45 ("The facility expenditure limitations cover depreciation and general operating costs such as rent, utility charges, repairs, insurance, salaries of watchmen, etc."); Tech. Adv. Mem. 96-08-004 (Feb. 23, 1996) (entertainment facility disallowance applied to "fuel and oil, insurance, pilot's salary, repairs, hangar rental, and depreciation" with respect to an aircraft).

159. Preamble to Prop. Treas. Reg. §§ 1.274-9, -10, § 5(h), 72 Fed. Reg. 33,169, 33,173 (June 15, 2007).

160. *General Explanation of the Tax Reform Act of 1986* (the "Blue Book"), at 64 (J. Comm. Print 1987) ("the cost of transportation . . . is not reduced pursuant to this rule").

161. IRC § 274(a)(1)(B).

162. Treas. Reg. § 1.274-2(b)(1)(iii)(c).

163. Treas. Reg. § 1.274-2(e)(iii)(b); *see also General Explanation of the Revenue Act of 1978*, at 206 (J. Comm. Print 1979).

164. Preamble to Prop. Treas. Reg. §§ 1.274-9, -10, § 5(e), 72 Fed. Reg. 33,169, 33,172 (June 15, 2007).

165. Treas. Reg. § 1.274-2(e)(2)(i).

166. *Mediaworks, Inc. v. Comm'r,* T.C. Memo (RIA) 2004-177 (yacht was classified as entertainment facility).

167. Treas. Reg. § 1.170A-1(g).

168. *Orr v. United States*, 343 F.2d 553 (5th Cir. 1965).

169. Treas. Reg. § 1.162-20(a)(2).