Outline of Statement by

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At the Public Hearing on

Proposed Treasury Regulations Relating to the Use of Business Aircraft for Entertainment

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I appreciate the opportunity to provide comments on ways in which the proposed regulations relating to the use of business aircraft for entertainment might be modified to alleviate confusion and unnecessary administrative burdens for the owners and operators of business aircraft. I have filed extensive written comments on the proposed regulations, which, among other important issues, includes a request that the IRS and Treasury reconsider the decision to reject the primary purpose method of allocating expenses among flights. Today, however, I would like to focus your attention on issues relating to: (1) tax issues presented by charitable flights; (2) the treatment of the costs of providing security on entertainment flights; (3) the development of a Charter Rate Method Safe Harbor, (4) aggregation of aircraft, and – a key point— (5) the industry standard for defining the term "aircraft operating expenses."

1) <u>Background Regarding the NBAA</u>
   a) The National Business Aviation Association ("NBAA") represents more than 8,000 Member Companies, and is the leading organization for companies that own or operate general aviation aircraft to help make their businesses more efficient, productive and successful.
   b) There are about 15,000 business aircraft[2] registered in the United States. Only about 3 percent of those are flown by *Fortune 500* companies, while the remaining 97 percent

[1] Defined as fixed-wing turbine plus piston-twin general aviation aircraft registered in the United States and flown as business or corporate operations as determined by the FAA in 2002.

encompass a broad cross-section of operators, including governments, schools and universities, churches, farms, foundations, charitable organizations and businesses – large, medium and small. Business aircraft operators are registered in every state in the country.

2) Turning first to the need to address the tax problem faced by companies that use their aircraft for charitable flights,
   a) We appreciated the statement in section 1(a) of the Preamble explaining that flights to participate in charitable activities are not subject to the entertainment expense limitation. Because the subject of charitable flights was raised in the Preamble, I would like to take this opportunity to address the tax problem that companies face when using their aircraft for charitable purposes – an obstacle that this exclusion does not alleviate.
   b) Owners and operators of business aircraft regularly contribute the use of their airplanes for charitable purposes, often in support of national safety and relief efforts.
      i) One such example was the contribution of relief flights in the days and months following Hurricane Katrina.
      ii) Countless business aircraft flew medical and food supplies and relief workers to the hurricane-stricken areas and transported hurricane victims to safe grounds in new communities throughout the U.S.
   c) Under current tax law, charitable flights can result in the disallowance of otherwise deductible business expenses, because a charitable deduction is not allowed for fixed costs attributable to charitable flights, and there is no provision in the law allowing the deduction of such costs as business expenses (assuming the primary purpose of the flight was for charitable rather than business purposes).
   d) NBAA's written comments propose a remedy to this problem via an amendment to Treas. Reg. § 1.274-5 T and your attention on this charitable flight quandary, during the course of this rulemaking initiative would help ensure an appropriate deduction for companies that provide their aircraft for charitable purposes.
3) Additional costs to provide security on entertainment travel should not be subject to disallowance.
   a) Prop. Treas. Reg. § 1.274-10(b)(3) states that air travel is not business entertainment air travel merely because a taxpayer-provided aircraft is used for the travel as a result of a

bona fide security concern under Treas. Reg. § 1.132-5(m). This regulation does not, however, address the issue of whether the *additional* costs incurred to provide security will be included in the costs subject to the entertainment disallowance.

b) We are concerned that taxpayers will incorrectly interpret this regulation to mean that the additional costs to provide security are subject to the entertainment disallowance.

   i) *Additional costs to provide security on personal travel qualify as business expenses under § 162 and are not included in taxable fringe benefits to employees under § 132*. Present law regarding additional costs to provide security on travel for personal purposes is summarized in Treas. Reg. § 1.132-5(m)(1), which explains that a deduction is allowed for "the excess of the amount actually paid for the transportation over the amount the employee would have paid for the same mode of transportation absent the bona fide business-oriented security concerns." The additional security costs that would be deducible include the costs of a specially designed vehicle over the cost of a vehicle that the employee would otherwise use and the costs of a private aircraft over the cost that the employee would otherwise incur to fly. Moreover, the imputed income to an employee will be reduced for transportation provided in a specially designed employer-provided automobile or in an employer-provided aircraft.

   ii) A similar exclusion from the entertainment disallowance should be allowed for the additional costs of providing transportation-related security when there are bona fide business-oriented security concerns, in recognition of the non-entertainment aspect of the additional costs to provide security when a specified individual's personal safety is jeopardized because of his or her employment status with the taxpayer or his or her location in a dangerous geographic location for the taxpayer's purposes.

   iii) For example, suppose an employee of an engineering firm is working in a dangerous area (*e.g.*, for a contractor working on reconstruction efforts in Iraq, an oil company in a troubled country in Africa, or a manufacturer in a violence-prone area in South America). By precluding the engineering firm's deduction of the cost of safely transporting an employee from a dangerous geographic area to a safer location for rest and relaxation, the regulations provide an incentive for the engineering firm to

refrain from providing such security. The foreseeable result is an increased risk of kidnapping or other harm to the employee.

c) *Proposed Solution*. The regulations should be clarified to state that additional costs incurred to provide security on entertainment travel are not subject to disallowance.

i) Meeting the requirements for a "bona fide business-oriented security concern" under the fringe benefit rules should be sufficient to qualify for the exception, and the cost of the private air travel necessitated by such concerns in excess of the cost of a first class ticket for such travel should be treated as a security expense, with only the cost of the first class ticket treated as an entertainment expense.

ii) Particularly in view of the serious security risks for Americans in many parts of the world, our Government should take steps to protect American travelers, rather than use the tax laws to create disincentives for employers to provide security for their employees.

4) NBAA supports the careful creation of a Charter Rate Method Safe Harbor and we are committed to working with the Treasury Department and the IRS to develop that.

a) If properly constructed, this would be a practical and good solution to an administratively complex problem, eliminate the need for vast amounts of paperwork and recordkeeping and thus reduce an administrative burden on taxpayers.

b) One solution would utilize the charter rate data that CharterX[2] archives from more than 1,000,000 flight requests and charter quotes each year. Much like the SIFL rates are published by the Department of Transportation, a similar report with average charter rates for turbine aircraft could be developed as a Charter Rate Safe Harbor Table.

i) For example, the operator of a Cessna Citation V would use the average charter rate for that aircraft as published in the Charter Rate Safe Harbor Table.

ii) This is preferable to the taxpayer contacting a charter operator to provide a quote for a flight (when the taxpayer has no intention of booking that flight) but simply needs a written record for tax files.

[2] CharterX (www.CharterX.com) is the largest repository of air charter supply and demand data in the world. The company handles more than 3,000 charter quote requests daily and over 1 million flight requests and quotes each year. The company maintains an extensive database of published and actual charter rates and business activity.

c) Any Charter Rate Safe Harbor should not be limited to rates from those charter operators that have 10 or more aircraft on their FAA air carrier certificate, as the overwhelming majority of charter operators in the United States have fewer than 10 aircraft.

5) Aggregation of Aircraft

a) Prop. Treas. Reg. § 1.274-10(d)(4) provides that aircraft with similar cost profiles can be aggregated in the calculation of disallowed entertainment expense and that to have similar cost profiles the aircraft must have the same engine type and the same number of engines among other factors to be considered.

b) In the interest of administrative efficiency, NBAA believes these criteria should be less restrictive.

i) NBAA's Members have reported that their accounting systems are not sophisticated enough to divide many costs incurred by a flight department amongst specific aircraft, such as a two engine airplane vs. a three engine airplane.

ii) The restrictive aggregation regulations will require taxpayers to track expenses separately for each aircraft, and, when the costs are not readily identifiable with respect to a specific aircraft, it will require companies to go through complex analysis to allocate costs[4] among separate aircraft.

c) NBAA suggests that the number of engines should not be a litmus test, as a two engine aircraft can be more expensive to own and operate than a three engine aircraft.

6) Finally, I would like to explain the industry standard for the term "aircraft operating expenses."

a) Section 2(a) of the Preamble states that industry use of the term "operating costs" generally refers to all costs, fixed and variable, including depreciation, claimed on the taxpayers tax return.

b) NBAA believes this statement is incorrect and, in fact, the business aviation industry standard term for the words "operating expenses" is Direct Operating Costs (DOCs), which equates to variable costs incurred for a flight.

c) The entire industry -- NBAA, aircraft manufacturers and dealers, and industry publications such as Business & Commercial Aviation magazine, and aviation data, cost

[3] A few examples of costs that may be troublesome to allocate among aircraft include hangar rental, salaries to maintenance employees and pilots, umbrella insurance costs and management company fees.

and benchmarking companies such as Conklin & de Decker Aviation Information – *all* equate operating expenses with DOCs and exclude the fixed costs associated with aircraft ownership from these calculations.

   i) DOCs are those expenses incurred when *operating* the aircraft; examples include: fuel, additives, lubricants, landing fees, catering, crew lodging/meal expenses, pilots paid on an hourly basis, and certain engine/propeller/airframe maintenance required on an hourly utilization basis.

d) The use of DOCs is consistent with the Securities and Exchange Commission expectations for reporting the Aggregate Incremental Costs of executive perquisites.

e) Aircraft operating expenses are those costs that are linked to the operation of the aircraft on a flight hour or mileage basis.

f) Ownership costs are those that are paid regardless of whether aircraft flies or sits in the hangar, should not be included as operating expenses.

That concludes my prepared remarks and I would be happy to respond to any questions.