June 13, 2018

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2018-43)
1111 Constitution Avenue, N.W.
Washington, DC 20224

**Re: Recommendations for 2018-2019 Priority Guidance Plan (Notice 2018-43)**

Dear Sir/Madam:

This letter is submitted by the National Business Aviation Association ("NBAA") in response to the invitation published in Notice 2018-43 for recommendation of items for inclusion on the 2018-2019 Priority Guidance Plan.

NBAA represents more than 11,000-member companies and is the leading organization for companies that own or operate general aviation aircraft to make their businesses more efficient, productive and successful.

With passage of the Tax Cuts and Jobs Act, NBAA members are seeking guidance on certain aspects of the following provisions in P.L. 115-97:

- Sec. 13201: Temporary 100-Percent Expensing For Certain Business Assets
- Sec. 13304: Limitation On Deduction By Employers Of Expenses For Fringe Benefits
    - Disallowance of Entertainment Expenses
    - Disallowance of Commuting Expenses

The enclosures included with this letter provide details on our specific guidance requests. We believe guidance in these areas will assist with tax administration and answer questions that NBAA members have developed in their review of the Tax Cuts and Jobs Act.

Thank you in advance for your consideration of these requests. If you have questions, please contact me at (202) 783-9451 or sobrien@nbaa.org.

Sincerely,

Scott O'Brien
Senior Director, Government Affairs

cc: The Honorable David J. Kautter, Assistant Secretary (Tax Policy), Department of the Treasury and Acting Commissioner, Internal Revenue Service

Tom West, Tax Legislative Counsel, Department of the Treasury

William M. Paul, Acting Chief Counsel and Deputy Chief Counsel (Technical), Internal Revenue Service

**Request for Guidance on Sec. 13201 of PL 115-97**
**Temporary 100-Percent Expensing For Certain Business Assets**

Overview

The Tax Cuts and Jobs Act (TCJA) amended Internal Revenue Code (IRC) § 168(k) to provide for 100-percent bonus depreciation, allowing taxpayers an immediate deduction of the cost of qualifying property acquired and placed in service after Sept. 27, 2017 and before Jan. 1, 2027 (Jan. 1, 2028 for longer production period property and certain aircraft).

NBAA requests guidance on the following issues related to the extension and modification of 100-percent bonus depreciation.

**1. Prohibition on Prior Use of Used Property**

IRC § 168(k)(2)(A) has always provided that to qualify for bonus depreciation, the original use of the property must begin with the taxpayer. The TCJA expanded this original use requirement to permit bonus depreciation for used property, so long as "such property was not used by the taxpayer at any time prior to such acquisition." *See* § 168(k)(2)(E)(ii).

We believe that if the taxpayer conducts incidental "use" of the property, the property should still meet the acquisition requirements. For example, there are situations where a taxpayer could charter or conduct a demonstration flight on a business aircraft that it later acquires. For these types of flights, the taxpayer is not the operator of the aircraft, so the aircraft should not be viewed as having been "used" by the taxpayer for purposes of the original use requirement.

**2. Effective Date of Section 168(k)(8)**

The TCJA provides in § 168(k)(8) that property acquired by the taxpayer before September 28, 2017 and placed in service by the taxpayer after September 27, 2017 is subject to 50 percent bonus depreciation, and to a phase down of the bonus depreciation rate for property placed in service in subsequent years. Section 13201(h) of the TCJA provides an effective date rule under which the TCJA bonus depreciation provisions apply to property that is both acquired and placed in service after September 27, 2017. That section further provides that for purposes of this effective date rule, "property shall not be treated as acquired after the date on which a written binding contract is entered into for such acquisition."

This raises the question of when could § 168(k)(8) ever apply? Under the effective date provision described above, property acquired prior to September 28, 2017 would not be subject to the provisions enacted under § 13201 of the TCJA. Since § 168(k)(8) is a provision enacted under § 13201(a)(3)(B) of the TCJA, it could only apply to property acquired after September 27, 2017. Thus, because § 168(k)(8) only applies to property acquired before that date, § 168(k)(8) would apparently never apply. The inconsistent provisions leading to this conclusion do not appear to be intended.

We suggest this inconsistency be clarified by an explanation that § 168(k)(8) applies to property acquired prior to September 28, 2017, and placed in service after that date, notwithstanding the effective date provision in § 13201(h) of the TCJA.

To harmonize the provisions, the effective date provision in § 13201(h) under which the acquisition date is deemed to be no later than the written binding contract date should continue to apply for purposes of § 168(k)(8). Otherwise, property purchased after September 27, 2017, with a written binding contract prior to that date would not be subject to the TCJA provisions or § 168(k)(8) even with the modification suggested above. By default, such property would apparently be governed by prior law.

### 3. Self-Constructed Property

Generally, self-constructed property is "acquired" when construction begins, which is when significant physical work begins. Presumably, the taxpayer is not the actual manufacturer of the aircraft. Under the self-constructed property regulations, an aircraft is self-constructed by the taxpayer if it is constructed for the taxpayer pursuant to a written binding contract entered into before construction begins.

Suppose a taxpayer enters into a written binding contract for the construction of a new aircraft prior to September 28, 2017, and prior to the beginning of construction on the aircraft. Suppose further that construction actually begins after September 27, 2017.

Arguably, acquisition is deemed to occur when the written binding contract was entered into, prior to September 28, 2017, which would preclude the aircraft from qualifying for 100% bonus depreciation under the TCJA. This rationale treats the written binding contract to construct the aircraft as if it were a contract to buy the aircraft.

In our view, a written binding contract to engage a company to construct an aircraft should not be treated as a contract to purchase the aircraft. Under the view that a contract to construct an aircraft differs from a contract to purchase an aircraft, a self-constructed aircraft would be treated as acquired by the taxpayer when construction begins, rather than when the contract is signed to engage the company to construct it. Thus, if constructions begins after September 28, 2017, the aircraft could qualify for 100% bonus depreciation. We request guidance to clarify that the latter view is correct.

### 4. Written Binding Contract

To be a written binding contract, Treas. Reg. § 1.168(k)-1(b)(4)(ii)(A) requires that the contract be binding on the buyer, but it does not require that the contract be binding on the seller. This is logical, since the buyer is the taxpayer seeking to claim bonus depreciation on the aircraft. The regulation further provides that if there are liquidated damages, then the contract will not qualify as a written binding contract if such liquidated damages are limited to an amount less than 5%. While the regulation does not actually state that this liquidated damages provision is applicable to only the buyer and not the seller, that is the only logical interpretation. We request guidance be provided to clarify that this interpretation is correct.

**Request for Guidance on Sec. 13304 of PL 115-97**
**Disallowance of Entertainment Expenses**

Overview

The TCJA modified § 274 of the IRC such that entertainment expenses directly related to (or associated with) a taxpayer's trade or business are no longer deductible. Prior to passage of the TCJA, entertainment expenses that were directly related to (or associated with) a taxpayer's trade or business were generally deductible under § 274(a), subject to a 50 percent limitation in § 274(n).

Recommendations for Guidance

The TCJA modifications to § 274(a)(1)(A) present new and unexpected issues for companies that utilize business aircraft. NBAA requests the following guidance to interpret these legislative changes.

**1. Entertainment Expenses on Trips Primarily for Business**

The section-by-section summary of the TCJA provided by the Senate Finance Committee explains that the new limitation under § 274 is designed to "eliminate the subjective determination of whether such (entertainment) expenses are sufficiently business related." While the effect of the amendment is to eliminate deductions for entertainment expenses that are directly related (or associated with) business, many business trips involve a combination of activities, only some of which should be defined as entertainment.

The existing regulations defining entertainment under Treas. Reg. § 1.274-2(b) do not discuss the need to consider multiple activities undertaken on a single trip in the determination of whether the travel costs (*e.g.*, air travel, meals, and lodging) should be subject to the entertainment disallowance. Since the purpose of the TCJA amendment is to eliminate the need to determine whether an entertainment expense is sufficiently business-related, guidance is requested with respect to the treatment of entertainment expenses on trips that are primarily for business.

Such guidance should clarify that in the case of trips with multiple activities (some of which are entertainment), it is necessary to determine whether the trip is primarily for entertainment (and therefore subject to the disallowance), or primarily for a non-entertainment purpose (and therefore not subject to the entertainment disallowance). If the trip is primarily for non-entertainment purposes (such as business), then the entertainment disallowance should only apply to the direct costs of an entertainment activity undertaken on the trip. The deductibility of travel costs for a primarily non-entertainment trip (*e.g.*, air travel, lodging, meals) should be evaluated in accordance with the tax treatment of the non-entertainment purpose (*e.g.*, business).

For example, if an employee travels to a business meeting, and one evening during the trip the employee goes to a movie for entertainment, the company should not be subject to a disallowance for the travel costs related to the trip. Only the cost of the movie ticket should be a non-deductible entertainment expense.

This conclusion is supported by the conference report to the TCJA which states that the change to § 274(a)(1)(A) is intended to disallow "an activity generally considered to be entertainment, amusement or recreation." Since the legislative intent is to disallow the costs of the entertainment activity only, we request that guidance be provided to clarify that when entertainment expenses are incurred on a trip that is primarily for non-entertainment purposes, the entertainment disallowance under § 274(a) should not apply to the travel costs (*e.g.*, flight, meals, and lodging).

**2. Primary Purpose Test**

In making the above determination of whether the entertainment disallowance applies to only the direct costs of the entertainment activity (*e.g*., the movie ticket), or to the travel costs associated with the trip (*e.g.*, air travel, meals, lodging), guidance should clarify that the determination be made based on the primary purpose of the trip.

The primary purpose standard is already used to make the distinction between business or personal travel under Treas. Reg. § 1.162-2(b). In addition, the existing business entertainment regulations under Treas. Reg. § 1.274-2(c)(3)(iii) focus on the "principal character" of the trip. Thus, the primary purpose test is consistent with the test applicable for purposes of the ordinary and necessary business test under § 162, and the test used by the regulations to determine whether an entertainment activity is directly related to business.

In addition, Congress has stated that a primary purpose test should exist for purposes of determining if a trip is subject to a deduction disallowance. In the Joint Committee on Taxation Report accompanying the Revenue Act of 1978, the primary purpose test was set forth with respect to transportation facilities as follows:

> Similarly, expenses incurred with respect to certain transportation facilities, for example automobiles and airplanes are allowable to the extent allocable to travel undertaken primarily for the furtherance of a trade or business even if the taxpayer engages in some entertainment activities during the business trip.

Staff of the J. Comm. on Tax'n, 95th Cong., *General Explanation of the Revenue Act of 1978*, at 207-8 (J. Comm. Print 1978).

Treas. Reg. § 1.162-2(b) explains that the primary purpose determination should be based on reviewing the "facts and circumstances in each case." The regulations further explain that time spent on business or non-business activities is one of the factors in making this determination. Similarly, the principal character test provides that the relative amounts of time spent on entertainment and non-entertainment activities during the trip is not the only factor in determining the primary purpose. *See* Treas. Reg. § 1.274-2(c)(3)(iii).

We request guidance that confirms a primary purpose test applies for purposes of determining whether flight expenses are disallowed following the TCJA changes to § 274.

**3. Reconsideration of Situations Previously Viewed as Business Entertainment**

The business entertainment regulations under Treas. Reg. § 1.274-2(c), (d) present rules and examples addressing situations in which the exceptions for entertainment activities directly related to (or associated with) business apply. For example, the business entertainment regulation at Treas. Reg. § 1.274-2(c)(4) with respect to a clear business setting explains:

> Generally, entertainment shall not be considered to have occurred in a clear business setting unless the taxpayer clearly establishes that any recipient of the entertainment would have reasonably known that the taxpayer had no significant motive, in incurring the expenditure, other than directly furthering his trade or business.

The regulation then provides the example of a "hospitality room" at a trade show or convention, which it states would be directly related to business.

With the TCJA repeal of the business entertainment exceptions, it becomes necessary to examine whether certain events, which are discussed in the business entertainment regulations as examples of activities directly related to (or associated with) business, are actually "entertainment" in the first place.

Under § 274(a)(1)(A), "entertainment" is defined as "an activity which is of a type generally considered to constitute entertainment, amusement, or recreation." The clear business setting regulation described above recognizes the well-understood fact, that in most cases, attendees at a business trade show are not there for entertainment, amusement or recreation. While the clear business setting rule is presented in the context of the business entertainment exception, the common-sense reasoning underlying the analysis equally supports the conclusion that the hospitality room does not constitute an entertainment activity in the first place.

The necessity of reconsidering whether activities that can apparently qualify for the business entertainment exception are truly entertainment in the first place is broader than just activities occurring in a clear business setting.

Therefore, we request that guidance issued with respect to the TCJA changes to § 274(a)(1)(A), acknowledge that activities which had qualified for the business entertainment exception should not automatically be considered as constituting entertainment. In determining if an activity is actually entertainment, the relevant facts and circumstances should be considered.

**1. Qualified Business Use Under Section 280F(b)**

Under § 280F(b) there are special rules for an aircraft to qualify for accelerated depreciation. That section, and the regulations thereunder, provide that use of an aircraft in a trade or business of the taxpayer constitutes "qualified business use" for purposes of § 280F(b). *See* § 280F(d)(6)(B); Treas. Reg. § 1.280F-6(d)(2). Since § § 280F(b) and 274(a) do not cross reference each other, we believe it is clear that modifications to § 274(a) under the TCJA have no effect on the determination of "qualified business use" for purposes of § 280F, but we would appreciate clarification of that point.

**Request for Guidance on Sec. 13304 of PL 115-97**
**Disallowance of Commuting Expenses**

Overview

Business aircraft are sometimes used to transport employees between an employee's residence and place of employment. Under pre-2018 law, expenses attributable to these flights were deductible to the employer as compensation fringe benefits qualifying as ordinary and necessary business expenses under § 162 of the IRC.

New § 274(*l*) enacted under the TCJA provides that an employer may not deduct expenses incurred in providing transportation between an employee's residence and place of business, referred to herein as "commuting." This new subsection appears intended to be consistent with other provisions that deny deductions to employers for commuting benefits provided to employees on a tax-free basis. However, there is an exception in § 274(*l*)(1) that allows for deductions of commuting costs necessary for "ensuring the safety of the employee."

Recommendations for Guidance

NBAA requests guidance in the following areas to interpret this new subsection.

1. **Compensation Fringe Benefits Reported as Taxable Compensation to the Employee**

While new § 274(*l*) appears to backstop other provisions that deny deductions to employers for commuting benefits provided to employees on a tax-free basis, there is no reason to infer that it was intended to limit employer deductions for commuting benefits provided to an employee and properly reported as income to the employee. It is not uncommon for regulatory guidance to remedy unintended double-counting situations, such as by limiting the employer disallowance of an expense for an item which is treated as taxable compensation to an employee.

For example, in Treas. Reg. § 1.274-2(f)(2)(iii), the IRS issued guidance preventing such double-counting by limiting the disallowance of an employer's deduction for spousal travel under § 274(m)(3). At a minimum, the amount imputed to the employee for the commuting flight should be deductible by the employer. However, we believe that in the absence of specific "to the extent that" language limiting the deduction, as is found in § 274(e)(2)(B), the full amount of the expenses of a commuting flight should be deductible if the employer imputes the proper amount to the employee. Under Treas. Reg. § 1.274-2(f)(2)(iii), expenses subject to § 274(m)(3) are completely exempt from disallowance if the proper amount is imputed to the employee, and the same rule should apply to expenses described in § 274(*l*) in view of the nearly identical disallowance language in these two subsections.

2. **Deductible Business Travel Distinguished from Commuting**

Guidance should be issued to identify commuting flights subject to disallowance pursuant to the § 274(*l*)(1) reference to "travel between the employee's residence and place of employment."

It seems clear that § 274(*l*) should not apply to flights for business travel which would be deductible as ordinary and necessary business travel expenses under § 162 and would thus not be included in the employee's income. For example, when an employee travels from the employee's residence to the

employee's secondary place of employment in a different city than the employee's primary place of employment, the flights would be deductible as an ordinary and necessary business expense. *See* Rev. Rul. 99-7, 1999-1 C.B. 361 (daily transportation); Rev. Rul. 93-86, 1993-2 C.B. 71 (overnight travel); *Markey v. Comm'r*, 490 F.2d 1249 (6th Cir. 1974).

As a result, regulatory guidance under § 274(*l*) should make clear that the commuting disallowance does not apply to flights that are otherwise properly classified as deductible business travel.

3. **Only Marginal Costs of Providing Commuting Benefits Should Be Disallowed**

If an employee's flight is determined to be a commuting benefit provided by the employer, only the marginal cost of providing the commuting benefit should be potentially subject to the disallowance. This approach is supported by § 274(m)(3), which uses almost identical disallowance language, and only disallows the marginal costs of travel expenses with respect to a spouse, child or other non-employee on a business trip.

The disallowance of only marginal costs under § 274(m)(3) is explained very clearly in IRS Pub. 463, at 5 (2017), which discusses the rule under § 274(m)(3), and provides the example of a man traveling by car to Chicago for business with his wife who is not traveling for business. The example concludes that the disallowance under § 274(m)(3) applies, but since there are not marginal costs associated with his wife's presence, the man "can deduct the total cost of driving his car to and from Chicago."

Likewise, in Rev. Rul 56-168, 1956-1 C.B. 93, the IRS further explained that only expenses "because of the wife's presence" on a trip are non-deductible, meaning that only the marginal cost of a spouse traveling on the business trip should be disallowed. *See French v. Comm'r*, T.C. Memo. 1990-34; *Pohl v. Comm'r*, T.C. Memo. 1990-298; *Marlin v. Comm'r*, 54 T.C. 560 (1970), *acq*. 1970-2 C.B. xx.

Since the disallowance of expenses provided in new § 274(*l*) uses language almost identical to the language in § 274(m)(3), and neither of those sections includes a cross-reference to the entertainment disallowance rules under § § 274(a) or (e), the marginal cost disallowance approach of § 274(m)(3) should apply to any disallowance of commuting benefits under § 274(*l*). As business flights often include travelers with different destinations and purposes, looking at the specific marginal costs to the employer of providing the commuting benefit will provide the most accurate and equitable calculation of any potential disallowance.

For example, suppose an employer provides a flight on the company plane for five employees from its headquarters location to destination A. At destination A, four of the employees attend business meetings, while one of the employees is commuting to destination A. Using the marginal cost approach (from § 274(m)(3)), only the marginal cost of providing the commuting flight for the employee commuting to destination A should be potentially subject to disallowance. In this scenario, the marginal cost of providing the commuting flight to the employee would be negligible, as there is no significant additional cost to adding one more passenger on a flight.

Finally, as explained in item #1 above, assuming the required amount is imputed to the employee for the commuting benefit, no portion of the cost of the flight provided to the employee should be subject to the disallowance.

**4. Exception for Travel to Ensure the Safety of the Employee**

Guidance should be provided on the exception in § 274(*l*) for commuting expenses that are necessary for the safety of the employee. Currently, in Treas. Reg. § 1.132-5(m)(2)(ii) and (iii), there is guidance on how to establish that a "bona fide business-oriented security concern" exists for an employee, and what qualifies as an "overall security program."

This existing guidance should be used to provide a "safe harbor" exception in § 274(*l*), to determine which flights would be deemed to be for purposes of ensuring the safety of the employee. For purposes of § 274(*l*), if the independent security study requires that the employee travel on the employer aircraft due to a bona fide business-oriented security concern, then such flights would meet the exception that they are being provided to ensure the safety of the employee. Flights which were not covered by an independent security study, or an overall security program, would be evaluated as necessary to ensure the safety of the employee based on all the facts and circumstances.

**5. Section 274(*l*) Applies Only to Employees**

It would be helpful to clarify the definition of "employee" for purposes of § 274(*l*)(1). The general definition of employee for purposes of the IRC is that which is provided for employment tax purposes. *See* Treas. Reg. § 31.3401(c)-1(b). Self-employed individuals, including independent contractors and partners, are generally not included in the definition of employee unless specifically provided by statute.

For example, § 129(e)(3) and 401(c) include self-employed individuals in the definition of employee for purposes of the dependent care assistance and qualified plan rules. Therefore, guidance should provide that the term "employee" does not include independent contractors or partners.

Guidance should also be provided to clarify that the term "employee" under § 274(*l*)(1) does not include 2% shareholders of Subchapter S corporations. Under § 1372, such shareholders are not employees for fringe benefit purposes. In Chief Counsel Advice 2003-44-008 (Jul. 1, 2003), the IRS further explained that 2% shareholders of Subchapter S corporations are not "employees" for purposes of § 274(e)(2) and the same analysis should apply under new § 274(*l*).

6. **No Effect on Qualified Business Use Under Section 280F(b)**

Under § 280F(b) there are special rules for an aircraft to qualify for accelerated depreciation. That section, and the regulations thereunder, provide that use of an aircraft in a trade or business of the taxpayer constitutes "qualified business use" for purposes of § 280F(b). *See* § 280F(d)(6)(B); Treas. Reg. § 1.280F-6(d)(2). Since § 280F(b) and 274(*l*) do not cross reference each other, it is clear that the amendment to add §274(*l*) under the TCJA should have no effect on the determination of "qualified business use" for purposes of §280F, but we would appreciate clarification of that point.