

The Reward for Filling the Cabin: More Money



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The more
on board
the merrier,
tax-wise.

“How can we hide the jet?” This question has been posed too frequently for way too long now.

Some flying “off the balance sheet” has always occurred at the fringes of our industry, but now it is becoming mainstream. It shouldn’t be. You can block N-numbers on tracking software and create a leasing labyrinth to hide aircraft ownership, but you can’t prevent someone from snapping a picture of the boss stepping out of the jet.

Creating a corporate aircraft use policy that maximizes use of the asset is the right thing to do, but what’s the practical, bottom-line reward for putting more butts in seats? For U.S. operators, it’s tax deductions.

Bonus depreciation is back. The last time it was available, there were very few aircraft in the market that clearly qualified. But the current recession, along with the dump-the-airplane-now reaction of many operators in the face of congressional and media hostility toward corporate aircraft have combined to produce a buyers’ market.

The trick to making sure that your company gets the full benefit of newly available tax deductions is really no trick at all: Put the aircraft in the company and make full use of it. That’s the key to getting full benefits. The two most-common tax traps for corporate aircraft are the IRS passive activity rules and entertainment rules.

IRC § 469 disallows using “passive activity” losses to offset “active” income. This statute and the accompanying regulations are a complex set of rules designed to prevent taxpayers from benefiting from loss deductions from equipment that is not directly related to their “active” business.

An activity is deemed passive if it is a trade or business in which the taxpayer does not materially participate, or is a rental activity. Anytime a corporation chooses not to own aircraft directly, the passive activity rules must be addressed. There are good reasons to set up an aircraft lease structure that are not based on “hiding” the aircraft, and under the right circumstances, the flight operation can be “grouped” with the main corporate business so that deductions are not lost. However, the IRS does not care about FAA restrictions, nor does the FAA care about your tax considerations. Too often, tax planners create aircraft charter operations without telling anyone in the flight department about charter payments that violate FAR Part 91. These structures often incur unexpected Federal Excise Taxes as well. The simple lesson of the complex passive activity rules is that you should own and operate your corporate aircraft in your company, not off the balance sheet.

Back in 2004, Congress amended IRC § 274 to limit a company’s deductions for “entertainment” use of corporate aircraft. Prior to that time, a company did not lose deductions for occasional non-business use of corporate aircraft as long as personal use was treated properly as a fringe benefit.

Fundamentally, a company loses deductions

for entertainment flights by “specified individuals.” How much? The IRS has issued proposed regulations explaining that to allocate costs to determine the entertainment deduction-disallowance, companies must use either the “occupied seat method” or the “flight by flight” method. Both of these methods allocate costs based on each passenger’s purpose for traveling.

Who is a “specified individual?” The full definition would consume nearly a page, and contains many nuances that attorneys and accountants have argued for some time. Think of it this way: If the corporate flight department will fly you on a non-business flight, you might be a specified individual. If you are an officer, director and/or own more than 10 percent of the company, you are a specified individual.

What constitutes “entertainment” under the rules? Only those flights conducted for hunting, fishing, vacation and similar activities. “Entertainment” does not include travel for reasons such as attending to business other than that of the employer or personal flights.

As noted, these calculations are complex. First, the total deductible expenses attributable to the aircraft must be allocated to entertainment of specified individuals or to all other uses. A taxpayer must allocate expenses for each taxable year using a flight-by-flight, occupied seat hours or miles flown by the aircraft methodology, and must apply the chosen method consistently for all usage for the taxable year.

Occupied seat hours or miles is the sum of the hours or miles flown by an aircraft multiplied by the number of seats occupied for each hour or mile. For example, a flight of six hours with three passengers aboard results in 18 occupied seat hours.

Although the calculations are complex, the lesson is simple: Put butts in seats. When the IRS set out to attack entertainment use of corporate aircraft, they made a simple observation: In too many flight departments, the roster of employees who can use the company aircraft for business is highly restricted, and yet the number of guests of executives on entertainment flights is almost unlimited. That works out to too many butts on board for entertainment and not enough there to do business.

The IRS approach to looking at seat use rather than merely comparing flight hours is deadly to companies that never let anyone but the CEO and guests on the aircraft. What companies need to realize is that the IRS seat approach is virtually harmless to companies that have incorporated corporate aircraft shuttles in their flight operations, because the number of business butts in seats then dominates the calculation. That leaves the taxmen little room to disallow deductions for entertainment use of the aircraft by its owners, officers and directors. ■

Also see “Advice From Counsel: Put Butts in Seats,” May 2009, page 92.