

## **IRS Issues Final Regs on Employee Entertainment Use**

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After many years and many revisions, the IRS has finally issued final regulations interpreting the provision disallowing deductions attributable to the use of aircraft for entertainment purposes by specified individuals (the “anti-Sutherland provision”). Congress enacted this provision in 2004. In 2005, the IRS published their first interpretation of the provision in Notice 2005-45. In 2007, the IRS published proposed regulations which incorporated many helpful changes. The final regulations generally follow the proposed regulations.

Here are a few key provisions retained in the final regulations:

- Taxpayers can compute allocable deductions on a “flight by flight” basis. This is a much simpler alternative to the “occupied seat hours/miles” methods originally proposed by the IRS since those methods required aircraft owners to keep track of occupied seat hours or miles for the entire year.
- Taxpayers can compute depreciation subject to disallowance using the straight line method, rather than the accelerated method. This is particularly helpful if personal entertainment use is uncharacteristically high during the first years of ownership. However, there are also significant risks to making this election.

The final regulations contain very few new provisions. The most substantive change is a new rule that allows special treatment for an airline where the individual is traveling on a “regularly scheduled flights on which at least 90 percent of the seats are available for sale to the public”.

The final regulations contain several clarifications:

- The costs subject to disallowance can include “interest on debt secured by or properly allocated to an aircraft”.
- The costs subject to disallowance do not include costs allocable to the charter or lease of the aircraft to an unrelated third party.
- Where the taxpayer uses the straight line method to compute depreciation, there will be no depreciation disallowance in the last years where the taxpayer is not claiming a regular depreciation deduction on the aircraft.
- The disallowance amount, including reimbursements, is allocated to aircraft deductions on a pro-rata basis.

The final regulations contain several new examples to illustrate the application of the rules to deadhead flights and to show the allocation of the disallowance to different categories of expense and the impact of using the straight line method of computing depreciation.

The new regulations are effective August 1 for tax years beginning after that date. However, as a practical matter most aircraft owners should already be using the methods prescribed in the final regulations.

**ABOUT THE AUTHOR**

Phil Crowther, JD, MBA, CPA, has over 35 years of experience dealing with tax matters, including federal, state and local taxes. For the past 27 years, he has worked exclusively on aviation business and tax matters, first as tax manager at Cessna Aircraft and later in private practice advising aircraft owners, operators, brokers, and charter and management companies. He has utilized his broad business and tax background to provide comprehensive aviation business and tax planning advice to clients and has handled hundreds of tax audits and appeals. He is a member of the NBAA Tax Committee and regularly speaks and writes on aviation tax matters. He is an instrument-rated, commercial pilot.

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