Valuing
For more than 20 years, tax advisors have anxiously awaited the end of October, when they could start making the aircraft fringe benefit calculations for the year. While these rules have remained essentially unchanged, they are not the kind of subject that is easy to remember. The purpose of this article is to provide you with your annual refresher.

In general, the fringe benefit rules apply whenever a company allows an employee, or a guest of an employee, to use a company aircraft for a personal flight. For this purpose, a company includes a C corporation, an S corporation, an LLC, a partnership or other separate tax entity. Under the fringe benefit rules, the employer must treat the value of such personal use as additional compensation to the employee.

The tax laws define these terms quite broadly. A “fringe benefit” includes any benefit provided as compensation for services rendered to the employer. An “employee” includes anyone who renders services, including an officer, employee, partner or independent contractor. An “employer” is the recipient of the services. Where an employer is part of a controlled group of corporations or an affiliated group of employers, the rules treat the “employer group” as the employer.

The fringe benefit rules apply regardless of whether the employee uses a company aircraft or whether the employer charters or rents an aircraft for the employee. 

continued on page 40
However, the rules do not apply to a passenger who is a company guest and is not an employee or a guest of an employee. Similarly, the rules do not apply to a passenger who is merely an investor or a guest of an investor. Instead, the costs attributable to such passengers are generally nondeductible entertainment expenses or nondeductible distributions to an investor.

Contrary to popular misconception, the new rules disallowing the deduction of aircraft expenses associated with entertainment flights do not eliminate the need to make a fringe benefit calculation. The fringe benefit rules are completely separate from the disallowance rules. The only connection between the two is that the disallowance rules allow an offset for amounts treated as income under the fringe benefit rules. In effect, the disallowance rules result in the disallowance of expenses in excess of the fringe benefit amount. So the greater the employee fringe benefit amount, the lower the employer disallowance amount and vice versa.

Calculating Value

Under the general rule, the employer must value the fringe benefit by reference to fair market value. For aircraft, the value is the charter value or rental value, depending on whether the employer provides a piloted or unpiloted aircraft. The value is the same, regardless of how many guests the employee invites aboard the aircraft. In the case of a company aircraft, the employer should be able to use a block charter or rental rate, rather than the spot rate.

For example, let's say a CEO makes a personal trip from Wichita to New York on March 1, 2007 in a CitationJet. The flight time is three hours, the charter rate is $1,250 per hour and the rental rate is $1,000 per hour (with fuel and no flight crew). The only additional cost is a landing fee of $37.
Using a fair market value computation, the charter rate would be worth $1,250 times three hours, plus the landing fee, or $3,787. The rental rate would total $3,037. The value would be the same regardless of how many guests the employee takes.

**The SIFL Method**

As an alternative to the fair market value method, the employer may compute the value using the Standard Industry Fare Level method, which is primarily a “cents-per-mile” calculation. The employer must compute a separate value for each passenger (age two and above). The basic unit of value is a single flight. A flight begins when the employee or employee guest enplanes and ends when the employee deplanes at the destination. This ignores intermediate stops for fuel, or because of weather, or to allow other passengers to enplane or deplane the aircraft.

The steps to compute the fringe benefit amount for each passenger start with calculating the straight-line distance, in statute miles, between the departure airport and the destination airport. You can use online resources, such as the calculator on the NBAA Web site, to compute the distance for you. To convert from nautical miles to statute miles, multiply by 1.15.

Then use the SIFL table to compute the basic value for the trip. For the second half of 2006, the value is 20.71 cents per mile, dropping to 15.79 cents for miles 501 to 1,000 and 15.18 cents for miles over 1,500. For the first half of 2007, the value is 20.75 cents per mile for the first 500 miles, falling to 15.82 cents for the next 1,000 miles and 15.21 cents for miles in excess of 1,500. For the second half of 2007, the values change to 20.74 cents, 15.81 cents and 15.70 cents, respectively.

Once you get the basic SIFL, multiply it by the aircraft multiple. They are:

<table>
<thead>
<tr>
<th>MGTOW</th>
<th>Control Employee</th>
<th>Noncontrol Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 6,000 lbs.</td>
<td>62.5%</td>
<td>15.6%</td>
</tr>
<tr>
<td>6,001-10,000 lbs.</td>
<td>125.0%</td>
<td>23.4%</td>
</tr>
<tr>
<td>10,001-25,000 lbs.</td>
<td>300.0%</td>
<td>31.3%</td>
</tr>
<tr>
<td>25,001+ lbs.</td>
<td>400.0%</td>
<td>31.3%</td>
</tr>
</tbody>
</table>

The maximum certified takeoff weight is taken from the aircraft records. Use the “control employee” multiplier for any person who is a “control employee” (as defined below), or who is a spouse, dependent child, or a guest of a control employee. Add in the Terminal Charge, defined as $37.85 for the second half of 2006, $37.92 for the first half of 2007, and $37.91 for the second half of 2007.

*continued on page 42*
The resulting value is then added to the W-2 or 1099 income of the appropriate employee.

The final value obviously varies a great deal depending on whether the employee is a control employee or a non-control employee. If an employee has the authority to use the company aircraft, the employee is probably a control employee. Under the standard test, the following employees are control employees:

**Officers:** A Board- or shareholder-appointed, confirmed, or elected officer of the employer whose compensation is $90,000 or more, limited to the lesser of 1 percent of all employees (rounded up to the next highest integer) or 10 employees, arranged in order of compensation.

**Highly Paid Employees:** Employees (excluding independent contractors) whose compensation is $90,000 or more and who are among the top 1 percent most
highly paid employees of the employer (rounded up to the next highest integer) limited to a maximum of 50 employees.

**Stockholders:** Employees who own a 5 percent or greater equity, capital, or profits interest in the employer.

**Directors:** The directors of the employer.

**Retired Control Employees:** Certain retired control employees are control employees.

An employee who is a family member of a control employee is also a control employee. For this purpose, family members include brothers and sisters, step-brothers and step-sisters, spouse, ancestors, and lineal descendants.

Certain employees do not count when computing whether the employee meets the 1 percent criteria. These include employees without 1 year of service, certain part-time employees, minors, employees covered by a collective bargaining agreement and certain students. In addition, a 5-percent owner must count ownership interests held by certain related persons.

If an employer is part of an employer group, then employee compensation includes compensation received from all employers in the group. A 5-percent stockholder of any member of the group is a 5-percent stockholder of all members of the group. However, an officer or director must be an officer or director of the particular company.

The employer may elect to use a slightly different alternative test to determine whether an employee is a control employee. A different test applies to governmental employees.

Take the same CEO personal flight from Wichita to New York in the CitationJet calculated earlier: The straight-line distance is 1,275 statute miles. The CEO is a control employee. The aircraft maximum certified takeoff weight is 10,600 pounds.

The basic SIFL value comes out to $226.36, which is then multiplied by the aircraft multiple of 300 percent. Add in the terminal charge of $37.92 and the SIFL value is $717.00 per person. If the CEO takes four guests, the total SIFL charge will be $3,585, which is less than the charter value and more than the rental value.

*continued on page 44*
Special Rules

Some special rules apply to trips that mix business with pleasure or that combine types of passengers.

If a trip is primarily for business purposes, the SIFL rules provide that only the incremental value of the personal flights is taxable. The incremental value is the sum of the value of all of the flights, reduced by the sum of the value of the business flights. If a trip is primarily personal, then the personal flights are taxable as if there were no business flights. These rules should also apply where the employer uses the fair market value method.

The SIFL rules exempt personal flights taken by an officer, employee or partner, or by a spouse or dependent child of the preceding, where business travelers occupy 50 percent or more of the regular passenger seating capacity of the aircraft for the entire flight. The regular passenger seating capacity is the maximum number of seats that are legal for use on takeoff and have, at any time on or prior to the date of the flight, been on the aircraft (while owned or leased by the employer). Flight crew seats are included where the primary purpose of the crewmember’s flight is something other than serving as a member of the flight crew.

This exemption does not apply to a director or independent contractor. The exemption does not prevent an officer, employee or partner from having to pay tax with respect to a guest who is not a spouse or dependent child. Nevertheless, the guest is not taxable as
a control employee, even if the employee who invites the guest is a control employee.

An employer using the fair market value method may be able to compute the fringe benefit amount using an incremental cost approach.

Some employers require employees to reimburse the company for personal use. If the employee pays fair market value or more, the fringe benefit rules do not apply since there is no longer any compensation involved. Otherwise, the reimbursement reduces the fringe benefit amount, but not below zero. Some employers use timeshare agreements that require employees to pay the lesser of the timeshare amount or the SIFL value. Of course, the employer needs to make sure that any payments for transportation are in compliance with the FAA rules and do not violate the terms of the insurance policy.

Employers do not have to wait until January to make the fringe benefit calculation. The IRS allows employers to make this calculation as of the end of the tenth month of the tax year (e.g. the end of October). This gives employers extra time to make the calculations and allows employees to defer paying tax on trips taken during the last two months of the year – generally a busy time for personal trips.

If the employer uses the SIFL method to value any flight, the employer must use the SIFL method to value all flights. However, the IRS has indicated that where the disallowance rule applies, the employer may use the fair market value method for those flights. The IRS may require an employer who improperly uses the SIFL method to use the fair market value method.