Understanding Employee Personal Use on the Business Aircraft

Friday, 1/22/16 | 8:30 am – 11:30 am

PRESENTED BY:
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Today’s Seminar Topics

– Using SIFL to calculate the employee fringe benefit for non-business use of company aircraft
– Calculating the entertainment cost disallowance to the company for entertainment flights
– SEC reporting rules
– Documentation
– Tracking and reporting flight use
There are 2 sets of IRS Regulations for non-business use of Company Aircraft.

- **Imputed income for employees & guests**
  - Treas. Reg. 1.61-21

- **Entertainment Flight Cost Disallowance**
  - IRC 274(e)
Using SIFL to Calculate the Taxable Fringe Benefit to the Employee for Personal Flights in a Company Aircraft
• WHAT IS PERSONAL USE?

  – Non-business use of an aircraft provided by the company to an employee
    • Any chartered aircraft, fractional aircraft or wholly owned aircraft provided to the employee for non-business use
  – Non-Business
    • Flights for purposes other than the business of the company
    • Flights that are for the business of the passenger, but not the company’s business
      – Outside board meetings or for other companies business
    • Vacation, entertainment, recreation
• **OVERVIEW**
  – The FAA limits the ability of an Employee to reimburse the company under Part 91 for personal use
    • Any unreimbursed costs of an Employee’s personal use of the company aircraft must be included in the Employee’s income for federal income tax purposes
    • SIFL is a formula accepted by the IRS, as is the Fair Market Rule
• WHY SHOULD YOU CARE?
  – Tax costs to the company
    • Loss of deductions (Jed)
  – Tax costs to the Employee(s)
    • Increased income (Fringe Benefit/imputed income)
  – FAA enforcement
  – IRS enforcement
  – Your tax benefits depend on how you use the aircraft
VALUATION RULES

- **Fair Market Rule**
  - Also known as the Charter Valuation Rule
  - This is what it would cost to charter an equivalent aircraft
  - Typically higher amount than SIFL

- **SIFL Rule**
  - The Noncommercial Special Valuation Rule or the (IRS Code Section 1.61-21(g))
  - **NOTE** – The “SIFL” calculation is generally less than the actual cost of the flight. This may or may not be a good thing (i.e. Entertainment Use)
**VALUATION RULES** *(cont’d)*

- **Can the employee pay for this?**
  - IRS requires that an employee
    - Pay, or
    - Have the value imputed (added) to their income, for the benefit of flying on board a company aircraft for purposes not related to the business of the company.
  - Or a combination of both

- **FAA Rules**
  - In general, one cannot pay for non-business use of an aircraft, however imputation is good
    - **However**, new FAA Chief Counsel interpretation, which allows certain employees the ability to pay on certain occasions. (Caution: Application of Commercial FET)
**VALUATION RULES (cont’d)**

- If the employee wants to pay, there are other ways of being able to pay for Personal Use of aircraft
  - Timesharing – commercial FET
  - Dry leasing – State Taxes
  - Joint Ownership – Taxes associated with ownership
  - Charter – commercial FET
- Can still affect Entertainment Use!
  - Will be discussed by Jed
• **WHAT IS TIME-SHARING**

  – It is the lease of an aircraft with crew under FAR Part 91
  
  • 91.501(c)(1) - A "time sharing agreement" means an arrangement whereby a person leases his airplane with flight crew to another person, and no charge is made for the flights conducted under that arrangement other than those specified in paragraph (d) of this section;

  – Operational Control stays with the Lessor

  – There must be a written agreement in place and for aircraft that weigh >12,500, compliance with FAR 91.23 “Truth-in-Leasing”
WHAT CAN BE CHARGED UNDER A TIME-SHARING AGREEMENT?

(d) The following may be charged, as expenses of a specific flight, for transportation as authorized by paragraphs (b) (3) and (7) and (c)(1) of this section:

1. Fuel, oil, lubricants, and other additives.
2. Travel expenses of the crew, including food, lodging, and ground transportation.
3. Hangar and tie-down costs away from the aircraft's base of operation.
4. Insurance obtained for the specific flight.
5. Landing fees, airport taxes, and similar assessments.
6. Customs, foreign permit, and similar fees directly related to the flight.
7. In flight food and beverages.
8. Passenger ground transportation.
10. An additional charge equal to 100 percent of the expenses listed in paragraph (d)(1) of this section.
• **FEDERAL EXCISE TAXES**
  - Although Time-Sharing falls under FAR Part 91 (non-commercial for FAA purposes), the fact that you are charging for aircraft & crew (wet lease) makes the amount paid subject to the commercial Federal Excise Tax of 7.5% of amounts paid, plus a $4/person/leg segment fee.
    • Refund of fuel taxes.
  • **SEC** – How Time-Sharing might help you with SEC Reporting will be discussed by Jed
• **CONTROL vs NON-CONTROL EMPLOYEE**
  
  – **Control Employee**
    • Owns 5% of more of company;
    • Paid in the top 1% of the company
    • Most officers or Directors
    • Retired former control employees
  
  – **Non-Control Employee**
    • Everyone Else
    – If an employee can authorize a personal use flight, the employee is probably a control employee.
- **SIFL**
  - SIFL Rates are published by the IRS & NBAA twice a year
    - **1/1/14 – 6/30/14**
      - 0 – 500 miles = $0.2515
      - 501 – 1500 miles = $0.1918
      - Over 1500 miles = $0.1844
      - Terminal Charge = $45.98
    - **7/1/14 – 12/31/14**
      - 0 – 500 miles = $0.2530
      - 501 – 1500 miles = $0.1929
      - Over 1500 miles = $0.1855
      - Terminal Charge = $46.25
- **SIFL** *(cont’d)*
  - Aircraft Multiples have been the same since the rule came out in 1989

<table>
<thead>
<tr>
<th>Weight</th>
<th>Control Employee</th>
<th>NonControl Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>6000 lbs or less</td>
<td>62.5%</td>
<td>15.6%</td>
</tr>
<tr>
<td>6,001 – 10,000</td>
<td>125%</td>
<td>23.4%</td>
</tr>
<tr>
<td>10,001 – 25,000</td>
<td>300%</td>
<td>31.3%</td>
</tr>
<tr>
<td>25,001 or more</td>
<td>400%</td>
<td>31.3%</td>
</tr>
</tbody>
</table>
- **CALCULATING SIFL**
  - Per person, per leg
  - On all types of aircraft, including helicopters
  - Value international flights
  - Value personal use on Part 135 aircraft
    - Sell seats versus sell aircraft
  - Any individual who is less than 2 years of age, is always valued at zero
CALCULATING SIFL (cont’d)

- Definition of a Flight
  - The distance is measured in Statute Miles
  - From where the individual boards the aircraft to where the individual deplanes
  - Round Trip = 2 flights
  - On a passenger-by-passenger basis
- Deadhead flights are not valued
- Mileage incurred in an Intermediate Stop not included in mileage
CALCULATING SIFL (cont’d)

- Information Needed
  - Status & Type of Passengers
    - Business vs non-business
    - Control vs non-control employee
  - Current SIFL Rates & Terminal Charge
  - Aircraft Multiples
  - Aircraft Weight
  - Flight Information – such as # of flights/legs and distance in statute miles
CALCULATING SIFL (cont’d)

Example

Assumptions

- Aircraft weighs more than 25,000 pounds
- The one way trip is 2000 statute miles
- A Control and a Non-Control employee are on board
- Date of trip August 13, 2014
500 x $0.2530 = $126.50
1000 x $0.1929 = $192.90
500 x $0.1855 = $ 92.75
Total $412.50
**Control Employee**

\[4(\$412.50) + \$46.25\]

\[= \$1,648.60 + \$46.25\]

\[= \$1,694.85 \text{ per person}\]

**Non-control Employee**

\[.313(\$412.50) + \$46.25\]

\[= \$129.11 + \$46.25\]

\[= \$175.36 \text{ per person}\]
MOST COMMON SPECIAL RULES

- Seating Capacity Rule – AKA the 50% Rule
  - If 50% of the seating capacity of the aircraft is filled with passengers on business, then someone occupying an empty seat could realize a zero valuation.
  - This rule only applies to employees, spouses or dependent children - Not to guests (cousin, friend, non-dependent children, etc.)
    - If the 50% rule is met, a Guests’ travel would be valued at the non-control employee rate, regardless of whose guest they are.
  - Board Member - A Board member is not an employee for purposes of this section, therefore a Board member cannot realize a zero valuation.
    - However, see guests above.
MOST COMMON SPECIAL RULES

Primarily Personal versus Primarily Business

- Trip primarily for employer's business
  - Value all 3 legs, then
  - Value the trip as if the personal leg did not occur
  - Subtract the 2nd from the 1st and the difference is what is added to the employees income

- Trip primarily personal
  - Value the flight from the Personal Destination to home, this is what is added to the employees income.
MOST COMMON SPECIAL RULES

- Trip primarily for employer’s business
  - Value all 3 legs, then
  - Value the trip as if the personal leg did not occur
  - Subtract the 2nd from the 1st and the difference is what is added to the employees income.

- Primarily personal trip
  - Value the flight from the Personal Destination to home, this is what is added to the employees income.
MOST COMMON SPECIAL RULES

- **Seating Capacity Rule**, *(cont’d)*
  - **24 month rule** - The seating capacity of the aircraft must remain the same for 24 months
  - **Flight Crew** - Seats occupied by the flight crew are not considered in the calculation of the seating capacity of the aircraft.
    - Jump Seat
    - Or a seat that is not used by anyone other than crew for take-off and landing
MOST COMMON SPECIAL RULES

Spouse Travel

- An employer can deduct for spousal travel as a business expense as long as certain conditions are satisfied under Section 274(m)(3).
  - Spouse is an employee, and
  - Trip is for a “Bona fide” business purpose, and
  - Expenses are otherwise deductible
MOST COMMON SPECIAL RULES

Spouse Travel (cont'd)

- Expenses Likely Taxable When
  - No formal request for family member to attend event(s)
  - Family members *Are not required* to attend meetings, *Are not given* assignments in advance or *Do not make* presentations at the event(s)
  - Children or other family members make trip
  - Family member performs only “helpful” services, such as limited note taking, secretarial services, etc.
  - Family members participate in substantial tourist activities (shopping, sightseeing, etc.)
MOST COMMON SPECIAL RULES

Spouse Travel (cont’d)

Expenses Likely “Bona Fide” When

- Formal or official correspondence requests spouse or other family members of Co employees make trip or attend event(s)
- Spouses are required to attend meetings, given assignments in advance or make presentations at the event(s)
- Children or other family members do not make trip
- Family member performs “necessary” services by acting as a representative of Company in a substantial manner
- Non-Company individuals (alumni, donors, recruits, etc.) attend event(s)
- Family members do not participate in tourist activities
MOST COMMON SPECIAL RULES

Security Rule

If the employee falls under the Safe Harbor Rule (IRC Section 1.132-5(m))

- What is this?
- Then they can use a 200% multiple regardless of the weight of the aircraft and the status of the employee (control vs non-control)
- For control employees in aircraft that weigh over 10,000 pounds this could be a significant savings
- Change in use of this rule since 2005
  - Entertainment Use
Foreign travel in Excess of 7 Days

Foreign travel SIFL reduction rules apply if the following 2 conditions are met:

- Business trip outside the United States lasts for more than 7 days
- At least 25% of the individual’s time on the trip is devoted to non-business activities

If both conditions are met, SIFL may be reduced to the ratio of non-business days divided by total days.

Travel days and weekend days count as business days.

Does not apply to employees or guests traveling entirely for non-business purposes.
- Imputed Income (SIFL) is not a Deductible Company Expense
  - Imputed income is a non-cash fringe benefit
    - Company reports SIFL on employee’s W-2
    - If SIFL’d passenger does not receive a W-2, issue a 1099
    - Employee reports SIFL income on 1040, pays personal income tax
  - SIFL imputed income is not deductible to the company
Calculating the Entertainment Passenger Cost Disallowance
There are Two Sets of IRS Regulations for Non-business Use of Company Aircraft

- IRC 274(e)
- Imputed income for employees & guests Treas. Reg. 1.61-21

IRC 274(e)
Cost Disallowance
Company Deductions

W-2 Employee
Types of Company Flights

- **Business Flights** – Flights that are incidental to the companies’ business
  - No SIFL, fully deductible
- **Non-Business Non-Entertainment Flights (NBNE)** – Flights that are for business, but not the business of the company owning or operating the aircraft
  - SIFL, no cost disallowance
- **Entertainment Flights** – Flights that are for transportation to activities that provide entertainment to the passengers
  - SIFL and cost disallowance both apply
Flights Subject to Cost Disallowance
100% Deductible
All Flights

Business
100% Deductible

NBNE
100% Deductible

Entertainment
All Flights

- Business
  - Deductible

- NBNE
  - Deductible

- Entertainment
  - Deductible up to SIFL
What Is Entertainment?

- “Entertainment” means any activity which is generally considered to constitute entertainment, amusement or recreation: Treas. Reg. 1.274-2(b)(1)
- “Entertainment use is an amusement or recreational activity, such as traveling to a sporting event or a vacation destination” Notice 2005-45
- An activity not “directly related to” or “associated with” the active conduct of a trade or business
- Entertainment is often described as a frame of mind…passenger expects enjoyment after flight
Examples Of Non-Entertainment:

• Attending to business that is not the business of the company that owns the aircraft
  ▪ Caution about flights to seek “investments.” These could be treated as investing expenses, subject to reporting on Schedule A

• Attending a meeting of the Board of Directors of an unrelated company

• Accompanying a spouse to a business event

• Charitable flights, such as Angel Flights

• Routine personal activities
Examples Of Non-Entertainment

- **Routine Personal Activities**
  - Commuting flights
  - Flights with investment advisor, attorney, accountant
  - Flight to take child to boarding school or college
  - Flight to attend funeral
  - Key is lack of entertainment, not “routine” nature of the activity
Specified Individual

- Entertainment reporting requires the presence of a Specified Individual; if no Specified Individual is on the flight, then no entertainment disallowance.

- A Specified Individual is anyone in the company who is subject to section 16(a) of the Securities Exchange Act, or any individual who would be subject to it if the company were an issuer of equity securities subject to the Securities Act.

- Specified individuals generally include officers, directors, 10% owners, principal financial officers, vice presidents in charge of a principal business unit division or function.
1. **Occupied Seat Miles**: Annual entertainment passenger seat miles divided by total passenger flight seat miles

2. **Occupied Seat Hours**: Annual entertainment passenger seat hours divided by total passenger flight seat hours

3. **Flight-By-Flight Miles**: Annual entertainment flight miles divided by total flight miles

4. **Flight-By-Flight Hours**: Annual entertainment flight hours divided by total flight hours
**Disallowance Calculation Example**

- 2,000 mile flight with 3 business passengers and 2 entertainment passengers; example using Occupied Seat Miles method

<table>
<thead>
<tr>
<th></th>
<th>Total Miles</th>
<th>Business</th>
<th>Entertainment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Flight miles</td>
<td>2,000</td>
<td>2,000</td>
<td>2,000</td>
</tr>
<tr>
<td>Passengers</td>
<td>X 5</td>
<td>X 3</td>
<td>X 2</td>
</tr>
<tr>
<td>Occupied Seat Miles</td>
<td>10,000</td>
<td>6,000</td>
<td>4,000</td>
</tr>
<tr>
<td>Use Percentage</td>
<td>100%</td>
<td>60%</td>
<td>40%</td>
</tr>
</tbody>
</table>

The objective is to calculate an entertainment disallowance percentage. The taxpayer may use the lowest of the four (4) methods allowed for calculating the percentage.
Deadhead Flight Rules

- Deadhead flights are flights with no passengers
- Deadhead flights must be treated as passenger flights for calculating OSH, OSM, or flight-by-flight hours or miles
- “Passengers” are “ghosted” and classified according to the previous or subsequent passengers for the flights with which they are associated
- If the deadhead is related to one occupied flight, the deadhead passenger count is easy to determine
Deadhead Flight Rules

Leg 1 = Occupied Leg
4 Business Passengers

Deadhead return leg:
Calculate using 4 business passengers
Deadhead Flight Rules

- When the deadhead flight is related to two or more flights, it may be determined two different ways:
  - The weighted average method calculates the passenger by OSM or OSH methods
  - Flight-by-flight method uses the percentage of each type of passengers on occupied flights before and after the deadhead
- The IRS gives examples of each method, and neither method accurately calculates the deadhead passengers
- Any realistic approach is probably acceptable providing it is applied in a consistent manner
Deadhead flights – IRS Example Flight-By-Flight Method

- Three legged flight
  - Leg 1: 6 hours, A-B, 12 pax, 8 business, 4 entertainment
  - Leg 2: 4 hours, B-C, deadhead (requires “ghosted” passengers)
  - Leg 3: 2 hours, C-A, 12 pax, 6 business, 6 entertainment
  - Total 12 flight hours and 24 pax, 14 business, 10 entertainment
# Deadhead Flights – Flight-by-Flight Method

<table>
<thead>
<tr>
<th>Leg</th>
<th>Total</th>
<th>Business</th>
<th>Entertainment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>12</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>2 (DH)</td>
<td>12</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>3</td>
<td>12</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Totals</td>
<td>36</td>
<td>20</td>
<td>16</td>
</tr>
<tr>
<td>100%</td>
<td>56%</td>
<td>45%</td>
<td></td>
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</tbody>
</table>

Ignore
Multi-leg Mixed Flights (Open-jaw)

- Flights with a combination of business and entertainment legs plus a return leg.
- The return leg may be prorated according to the ratio of OSH, OSM, or F-by-F passengers on the other legs.
- The entertainment cost of a multi-leg trip is the total cost of the flights minus the cost of the flights that would have been taken without the entertainment segment or segments (IRS definition).
Open-Jaw Flight – IRS Example

- Three legged flight, one specified individual on each leg
  - Leg 1: 2 hours business A-B
  - Leg 2: 3 hours entertainment B-C
  - Leg 3: 4 hours return C-A
  - Total 9 flight hours

Without Open Jaw Allocation Calculation

9 Total flight hours
-2 Business hours
7 Entertainment hours
Open-Jaw Flight – IRS Example

- Three legged flight, one specified individual on each leg
  - Leg 1: 2 hours business A-B
  - Leg 2: 3 hours entertainment B-C
  - Leg 3: 4 hours return C-A
  - Total 9 flight hours

Without Open Jaw Allocation Calculation

9  Total flight hours
-2  Business hours
7  Entertainment hours

Step 1: Calculate as if flight was only business
Step 2: Add Entertainment hours/miles to reach total

Allocation Calculation
9  Total flight hours
-4  Hours if trip was only business (A-B + B-A)
5  Entertainment hours
Securities and Exchange Commission (SEC) Reporting of Executive Non-Business Use of Company Aircraft
SEC Reporting

Reporting of Executive and Director Compensation and Related-Party Transactions required in Non-financial Statement portion of:

- Registration statements
- Annual reports
- Proxy and information statements
- Other documents
SEC Regulation S-K Item 402(a) requires clear, concise and understandable disclosure of all compensation awarded to, earned by, or paid to:

- A company’s Principal Executive Officer (PEO), Principal Financial Officer (PFO), plus 3 most highly compensated executive officers who exert significant policy influence in the company
- Directors compensated for services provided as directors (see 402(g))
- Includes transactions between the company and a third party where the primary purpose of the transaction is to furnish compensation to a named executive officer
- Use of company aircraft as a form of compensation requires disclosure
Reporting of Executives’ “Other Compensation”

- SEC Regulation S-K Item 402(b) (17 CFR 229.402(b)) requires disclosure of non-cash compensation in Summary Compensation Table, Under Column (e), “Other Annual Compensation”
- Report the dollar value of other annual compensation not properly categorized as salary or bonus.
- Includes perquisites and other personal benefits, securities or property, unless the aggregate amount of such compensation is less than $10,000.
Reporting of Executives’ “Other Compensation”

• If the perquisite is $10,000 or greater it must be identified.

• If it is valued at the greater of $25,000 or ten percent of total compensation, its value must be disclosed, identified by type and amount in a footnote or accompanying narrative discussion to column (e).

• Perquisites and other personal benefits shall be valued on the basis of “aggregate incremental cost” to the company and its subsidiaries.
Aggregate Incremental Cost

• SEC Release dated September 23, 1983 – Focus of Item 402 is disclosure of the cost of management to registrants.

• The SEC does not provide a further definition of “incremental cost”

• Informal advice – cost to company of flights NOT value of flights (e.g. SIFL)

• Aggregate Incremental Cost = per flight direct operating costs (DOC’s)?
Relationships and Related-Party Transactions

SEC Regulation S-K, Item 404(a) (17 CFR 229.404(a)) requires disclosure of any transactions involving over $120,000 in which the company is a party where a direct or indirect material interest is held by:

- Any director or executive officer of the registrant;
- Any nominee for election as director;
- Any security holder of more than 5%; and
- Any member of the immediate family of any of the foregoing persons.
• DOCUMENTING USE
  – Substantiate the Use (IRC 274(d))
    • Dates of departure and return
    • Name of host/lead employee
    • Who else is on board
    • Passengers names and relationship to company
    • Business reason for travel or nature of business benefit expected, *for each passenger*
    • Number of days spent on business and personal, for each individual
• DOCUMENTING USE (cont’d)

– Other Information
  • Aircraft info, such as seating capacity
  • Origin of flight, destination, intermediate stops and airport identifiers

– Consistency is very important

– Poor or no documentation could mean taxable benefit to employee and loss of aircraft deductions for company
• **DOCUMENTING USE** (*cont’d*)
  
  – Have Adequate Records (Treas Reg 1.274-5T(b)(2))
    • Log, trip sheet, etc. anything sufficient to back up each element
    • Written statement of business or personal non-entertainment use purpose
      – For each passenger on the aircraft
      – Maintained at or near time of event
• CHARACTERIZE THE USE
  – For all employees and guests on every flight
    • Identify the passenger
      – Name of passenger, particularly if you are claiming business or personal non-entertainment
      – Control or Non-control Employee or guest of same
      – Specified individual, or not, or guest of same
    • Determine Primary Purpose
      – Facts & circumstances
      – Amount of time spent on each activity
      – What is the relationship between the business activity and transportation costs
– CHARACTERIZE THE USE (cont’d)

• Determine Primary Purpose (cont’d)
  – Existence of an agenda, location of the activity, presence of spouse or guest, how is the trip characterized.
  – Is the purpose for the business of the company providing the flight (Business) or
  – If it is not Business then it is Personal
    » Personal Non-entertainment? Or
    » Personal Entertainment
• **COMMON STRATEGIES**
  
  • Capture as much of the necessary information prior to the flight
    – Flight Logs
      » How many passengers
      » Control Employees and/or Specified Individuals
      » Where each is passenger going
      » Miles, hours
      » Passenger manifest
      » Intermediate stops
    – Details of all expected expenses
• COMMON STRATEGIES
  • Capture as much of the necessary information prior to the flight
    – Who is on the aircraft and why?
      » If for business what documents do I have to substantiate this?
        • Emails, calendar items, invitations, letters, invoices, etc.
    – Is this a Time-Sharing flight
• COMMON STRATEGIES
• Document Recurring Scenarios
  – If you have recurring flights, document how these flights have been handled – Be Consistent
    » Flights between HQ and other company locations
    » Flights to major customers, vendors or industry events
    » Deadheads, commuting to/from 2nd home
    » Recurring employees & guests
  – How are these flights be treated for SIFL Purposes, Entertainment Use, Time-Sharing, etc.
  – How are spouses or non-employees be treated
• COMMON STRATEGIES
  • Employ a Corporate Aircraft Use Policy
    – This will save time in the future and provides consistency
      » Corporate Policy vs Individual Judgments
      » Institutes an approval process for employee use of aircraft
      » Describes how flights of guests and/or spouses are handled or even allowed.
      » Discusses the tax treatment of recurring scenarios
      » May address the internal accounting for the departments using the aircraft.
• COMMON STRATEGIES
  • Personal Use Group
    • This could consist of anyone who deals with the aircraft/flight department, such as
      – Chief Pilot, Flight Dept manager, Scheduler/Dispatcher, tax department, accounting department, human resources, executive assistance, owner, etc.
    • Communicate on a regular basis with affected persons
• COMMON STRATEGIES
  – Develop consistent accounting processes
    • Review flights on a regular and consistent basis
      – Maybe month-by-month, or quarter.
        » Remember the longer between the flight and review, the more apt one is to forget what was the purpose of the flight and may even loss of records.
    • Develop an objective and standardized approach to classifying flights
TRACKING & REPORTING
SIFL and ENTERTAINMENT COST DISALLOWANCE
FOR YEAR END REPORTING
Accumulating SIFL and Entertainment Disallowance Data During the Year

- Calculating and accumulating the SIFL data can be tedious and time consuming

- Excel spreadsheets are a low-cost, simple solution
  - You must know all the rules
  - Spreadsheets are prone to math errors
  - Typically won’t meet the IRS documentation requirements

- Computer software offers many advantages
  - Our software is the only product designed for accountants, CPAs and flight departments
  - “Enter once” input for SIFL, cost disallowance, state tax, SEC, etc.
  - Designed to satisfy IRS reporting and documentation requirements
<table>
<thead>
<tr>
<th>Flight</th>
<th>Leg</th>
<th>Date</th>
<th>From</th>
<th>To</th>
<th>Flight Type</th>
<th>Hrs.</th>
<th>Statute Miles</th>
<th>Total Pax</th>
<th>Business Pax</th>
<th>Pers Non-Ent Pax</th>
<th>Entertain Pax</th>
<th>Exempt Spouse &amp; Dependents</th>
<th>Non-Control Guests</th>
<th>0-500 Miles</th>
<th>501-1500 Miles</th>
<th>1500+ Miles</th>
<th>Per Diem</th>
<th>Mileage Meals</th>
</tr>
</thead>
<tbody>
<tr>
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<td>1</td>
<td>7/1/12</td>
<td>STL</td>
<td>MDW</td>
<td>Business</td>
<td>0.7</td>
<td>251</td>
<td>6</td>
<td>6</td>
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<td>STL</td>
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<td>Entertainment</td>
<td>2.1</td>
<td>874</td>
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<td>4</td>
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<td>Other Business</td>
<td>0.9</td>
<td>378</td>
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<td>0.00</td>
<td>0.00</td>
<td>97.11</td>
<td>300%</td>
<td>-</td>
<td>756</td>
<td>1.8</td>
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<td></td>
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<tr>
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<td>31.3%</td>
<td>2,380</td>
<td>4,760</td>
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<td>238</td>
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<td>PDK</td>
<td>STL</td>
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<td>31.3%</td>
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<td>4,760</td>
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<td>238</td>
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<tr>
<td>Flight 5: Deadhead Leg</td>
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<td>-</td>
<td>4.475</td>
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<td>77.5</td>
<td>39,062</td>
<td>215</td>
<td>215</td>
<td>20,40</td>
<td>2,530</td>
<td>15,182</td>
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<td>2,680</td>
<td>6.21</td>
<td>9.64%</td>
<td>9.40%</td>
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</table>

**FLIGHT INFORMATION**

**SIFL & Cost Disallowance Worksheet**

**SIFL CALCULATION**

**COST DISALLOWANCE**
## FLIGHT INFORMATION

<table>
<thead>
<tr>
<th>Flight Leg</th>
<th>Date</th>
<th>From</th>
<th>To</th>
<th>Flight Type</th>
<th>Date Type</th>
<th>Hrs.</th>
<th>Statute Miles</th>
<th>Total Pax</th>
<th>Business Pax</th>
<th>Non-Ent Pax</th>
<th>Total Seat Miles</th>
<th>Business Miles</th>
<th>Non-Business Miles</th>
<th>Subtotal Factor</th>
<th>Subtotal Miles</th>
<th>Entertainment</th>
<th>Subtotal Income</th>
<th>Reimbursed Entertainment Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Flight 1: Business Flight</td>
<td>1</td>
<td>7/1/12</td>
<td>STL</td>
<td>MDW</td>
<td>Business</td>
<td>0.7</td>
<td>251</td>
<td>6</td>
<td>6</td>
<td>0.00</td>
<td>128.45</td>
<td>73.27</td>
<td>300%</td>
<td>46.97</td>
<td>652.12</td>
<td>2,508</td>
<td>5.20</td>
<td>-</td>
</tr>
<tr>
<td>Flight 2: Entertainment Flight</td>
<td>2</td>
<td>7/10/12</td>
<td>STL</td>
<td>ORL</td>
<td>Entertainment</td>
<td>2.1</td>
<td>874</td>
<td>4</td>
<td>4</td>
<td>0.00</td>
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<td>73.27</td>
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<td>2,508</td>
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<td>-</td>
</tr>
<tr>
<td>Flight 3: Personal Non-Entertainment Flight</td>
<td>3</td>
<td>8/1/12</td>
<td>STL</td>
<td>AAO</td>
<td>Other Business</td>
<td>0.9</td>
<td>378</td>
<td>2</td>
<td>2</td>
<td>0.00</td>
<td>97.11</td>
<td>0.00</td>
<td>300%</td>
<td>46.97</td>
<td>652.12</td>
<td>2,508</td>
<td>5.20</td>
<td>-</td>
</tr>
<tr>
<td>Flight 4: 50% Seating Capacity</td>
<td>4</td>
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<td>STL</td>
<td>PDK</td>
<td>Mixed</td>
<td>1.0</td>
<td>476</td>
<td>10</td>
<td>5</td>
<td>0.00</td>
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<td>33.33</td>
<td>300%</td>
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<td>Business</td>
<td>77.5</td>
<td>39,062</td>
<td>215</td>
<td>215</td>
<td>91.7</td>
<td>45,154</td>
<td></td>
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</tbody>
</table>

### SIFL & Cost Disallowance Worksheet

<table>
<thead>
<tr>
<th>Flight Leg</th>
<th>Date</th>
<th>From</th>
<th>To</th>
<th>Flight Type</th>
<th>Date Type</th>
<th>Hrs.</th>
<th>Statute Miles</th>
<th>Total Pax</th>
<th>Business Pax</th>
<th>Non-Ent Pax</th>
<th>Total Seat Miles</th>
<th>Business Miles</th>
<th>Non-Business Miles</th>
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</tr>
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<td>Flight 1: Business Flight</td>
<td>1</td>
<td>7/1/12</td>
<td>STL</td>
<td>MDW</td>
<td>Business</td>
<td>0.7</td>
<td>251</td>
<td>6</td>
<td>6</td>
<td>0.00</td>
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<td>73.27</td>
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</tr>
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<td>2</td>
<td>7/10/12</td>
<td>STL</td>
<td>ORL</td>
<td>Entertainment</td>
<td>2.1</td>
<td>874</td>
<td>4</td>
<td>4</td>
<td>0.00</td>
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<td>73.27</td>
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<td>-</td>
</tr>
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<td>Flight 3: Personal Non-Entertainment Flight</td>
<td>3</td>
<td>8/1/12</td>
<td>STL</td>
<td>AAO</td>
<td>Other Business</td>
<td>0.9</td>
<td>378</td>
<td>2</td>
<td>2</td>
<td>0.00</td>
<td>97.11</td>
<td>0.00</td>
<td>300%</td>
<td>46.97</td>
<td>652.12</td>
<td>2,508</td>
<td>5.20</td>
<td>-</td>
</tr>
<tr>
<td>Flight 4: 50% Seating Capacity</td>
<td>4</td>
<td>10/18/12</td>
<td>STL</td>
<td>PDK</td>
<td>Mixed</td>
<td>1.0</td>
<td>476</td>
<td>10</td>
<td>5</td>
<td>0.00</td>
<td>122.28</td>
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<td>300%</td>
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<td>652.12</td>
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<td>-</td>
</tr>
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<td>Flight 5: Deadhead Leg</td>
<td>5</td>
<td>11/18/12</td>
<td>STL</td>
<td>PDK</td>
<td>Deadhead</td>
<td>1.8</td>
<td>763</td>
<td>7</td>
<td>5</td>
<td>0.00</td>
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<td>2,508</td>
<td>5.20</td>
<td>-</td>
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<td>77.5</td>
<td>39,062</td>
<td>215</td>
<td>215</td>
<td>91.7</td>
<td>45,154</td>
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Accumulating SIFL and Entertainment Disallowance Data During the Year

Several software options are available to simplify the aircraft tax reporting:

– Several aircraft scheduling software packages have SIFL calculation capabilities
– Few have entertainment cost disallowance capabilities
– Flight Tax Systems has both, plus state tax reporting
Pulling It All Together for the Tax Return
Adjusting Depreciation Costs
In determining the amount of expenses subject to disallowance under this section, a taxpayer must include all of the expenses of operating the aircraft, including all fixed and variable expenses the taxpayer deducts in the taxable year. These expenses include, but are not limited to:

Salaries for pilots, maintenance personnel, and other personnel assigned to the aircraft; meal and lodging expenses of flight personnel; take-off and landing fees; costs for maintenance flights; costs of on-board refreshments, amenities and gifts; hangar fees (at home or away); management fees; costs of fuel, tires, maintenance, insurance, registration, certificate of title, inspection, and depreciation; interest on debt secured by or properly allocated (within the meaning of §1.163-8T) to an aircraft; and all costs paid or incurred for aircraft leased or chartered to the taxpayer. 1.274-10(d)(1)
Facts: Aircraft cost $5 million, first year reporting, taxpayer claims 20% first-year MACRS depreciation. DOCs = $750,000, OC = $500,000, Depreciation = $1,000,000. Entertainment SIFL totals $45,300 for the year.

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
<th>Percentage</th>
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<td>Direct operating costs</td>
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</tr>
<tr>
<td>Ownership costs</td>
<td>500,000</td>
<td></td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>1,250,000</td>
<td>55%</td>
</tr>
<tr>
<td>Depreciation</td>
<td>1,000,000</td>
<td>45%</td>
</tr>
<tr>
<td><strong>Total costs and depr. (list all on return)</strong></td>
<td>2,250,000</td>
<td>100%</td>
</tr>
<tr>
<td>Entertainment SIFL (or reimbursement, whichever is greater)</td>
<td>45,300</td>
<td></td>
</tr>
</tbody>
</table>
• Step 1: Log flights and analyze each passenger as onboard for business, NBNA, or entertainment purposes
• Step 2: Calculate entertainment cost limitation percentage for the year
• Step 3: Add direct operating costs and ownership costs. Multiply by the disallowance percentage, add back the SIFL imputed income. List the disallowance amount as a contra-expense on the tax return
• Step 4: If reporting MACRS depreciation, calculate adjustment to straight-line depreciation and report as a contra-expense on the tax return
# Types of Company Flights

**Aircraft:** Turbine Aircraft 1  
**Flight Date:** 08/14/2015  
**Passengers:** 2  
**Arrival:** KIJKX

## Available Passengers

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<tr>
<th></th>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Mr. Howard Boss</td>
<td>Business</td>
<td>☑</td>
<td>☑</td>
<td>☑</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mr. Adam Employee</td>
<td>Non-Business</td>
<td>☑</td>
<td></td>
<td>☑</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ms. Assistant Employee</td>
<td>Entertainment</td>
<td>☑</td>
<td></td>
<td>☑</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mr. George Employee</td>
<td>Business</td>
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<td></td>
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<td></td>
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<tr>
<td>Mr. Vice Employee</td>
<td>Business</td>
<td>☑</td>
<td></td>
<td>☑</td>
<td></td>
<td></td>
</tr>
<tr>
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<td>Business</td>
<td>☑</td>
<td></td>
<td>☑</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business Associate</td>
<td>Business</td>
<td>☑</td>
<td></td>
<td>☑</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mr. Junior Boss</td>
<td>Business</td>
<td>☑</td>
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<td>☑</td>
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</tr>
</tbody>
</table>

**Same Passengers as Previous Leg:**  
- Copy Passengers

[Missing Information?] (Info)
- Step 1: Log flights and analyze each passenger as onboard for business, NBNA, or entertainment purposes
- Step 2: Calculate entertainment cost limitation percentage for the year
- Step 3: Add direct operating costs and ownership costs. Multiply by the disallowance percentage, add back the SIFL imputed income. List the disallowance amount as a contra-expense on the tax return
- Step 4: If reporting MACRS depreciation, calculate adjustment to straight-line depreciation and report as a contra-expense on the tax return
## FLIGHT INFORMATION

<table>
<thead>
<tr>
<th>Flight Type</th>
<th>Hrs.</th>
<th>Statute Miles</th>
<th>Total Pax</th>
<th>Business Pax</th>
<th>Pers Non-Ent Pax</th>
<th>Entertain Pax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business</td>
<td>77.5</td>
<td>39,062</td>
<td>215</td>
<td>215</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>91.7</td>
<td>45,154</td>
<td></td>
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</tbody>
</table>

## COST DISALLOWANCE

<table>
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<tr>
<th>Seat Method</th>
<th>Flight-By-Flight Method</th>
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</thead>
<tbody>
<tr>
<td>Entertain Seat Miles</td>
<td>Total Seat Miles</td>
</tr>
<tr>
<td>Business</td>
<td>15,182</td>
</tr>
<tr>
<td></td>
<td>21.8%</td>
</tr>
</tbody>
</table>

Summary: All Other Flights
Calculates entertainment cost disallowance under all four methods. Permits taxpayer to select the method that has the best results.
Calculating the Entertainment Disallowance

- Step 1: Log flights and analyze each passenger as onboard for business, NBNE, or entertainment purposes
- Step 2: Calculate entertainment cost limitation percentage for the year
- Step 3: Add direct operating costs and ownership costs. Multiply by the disallowance percentage, add back the SIFL imputed income. List the disallowance amount as a contra-expense on the tax return
- Step 4: If reporting MACRS depreciation, calculate adjustment to straight-line depreciation and report as a contra-expense on the tax return
Calculating the Cash-Costs Disallowance

Facts: Aircraft cost $5 million, first year reporting, taxpayer claims 20% first-year MACRS depreciation. DOCs = $750,000, OC = $500,000, Depreciation = $1,000,000. Entertainment SIFL totals $45,300 for the year

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
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<tbody>
<tr>
<td>Direct Operating Costs</td>
<td>$750,000</td>
</tr>
<tr>
<td>Ownership Costs</td>
<td>500,000</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td><strong>1,250,000</strong></td>
</tr>
<tr>
<td>Entertainment Disallowance Percentage</td>
<td>X 20.5%</td>
</tr>
<tr>
<td>Gross Disallowance</td>
<td>256,250</td>
</tr>
<tr>
<td>Add Back Entertainment SIFL (55% of total)</td>
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</tr>
<tr>
<td><strong>Net Entertainment Cost Disallowance</strong></td>
<td><strong>$231,335</strong></td>
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Reporting the Entertainment Cost Disallowance on the Tax Return Supporting Schedule

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<th>Expense</th>
<th>Amount</th>
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<td>Fuel</td>
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<tr>
<td>Insurance</td>
<td>24,295</td>
</tr>
<tr>
<td>Crew Salaries</td>
<td>195,000</td>
</tr>
<tr>
<td>Crew Travel Costs</td>
<td>9,732</td>
</tr>
<tr>
<td>Maintenance</td>
<td>135,000</td>
</tr>
<tr>
<td>Hangar</td>
<td>45,000</td>
</tr>
<tr>
<td>1.274-10(e) Cost Adjustment</td>
<td></td>
</tr>
<tr>
<td><strong>Line 26 - Total Other Deductions</strong></td>
<td><strong>$634,027</strong></td>
</tr>
</tbody>
</table>
Reporting the Entertainment Cost Disallowance on the Tax Return Supporting Schedule

<table>
<thead>
<tr>
<th>Expense</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fuel</td>
<td>$225,000</td>
</tr>
<tr>
<td>Insurance</td>
<td>24,295</td>
</tr>
<tr>
<td>Crew Salaries</td>
<td>195,000</td>
</tr>
<tr>
<td>Crew Travel Costs</td>
<td>9,732</td>
</tr>
<tr>
<td>Maintenance</td>
<td>135,000</td>
</tr>
<tr>
<td>Hangar</td>
<td>45,000</td>
</tr>
<tr>
<td>1.274-10(e) Cost Adjustment</td>
<td>-231,335</td>
</tr>
<tr>
<td>Line 26 - Total Other Deductions</td>
<td>$402,692</td>
</tr>
</tbody>
</table>
Step 1: Log flights and analyze each passenger as onboard for business, NBNE, or entertainment purposes.

Step 2: Calculate entertainment cost limitation percentage for the year.

Step 3: Add direct operating costs and ownership costs. Multiply by the disallowance percentage, add back the SIFL imputed income. List the disallowance amount as a contra-expense on the tax return.

Step 4: If reporting MACRS depreciation, calculate adjustment to straight-line depreciation and report as a contra-expense on the tax return.
Use of Straight-Line Depreciation for Disallowed Depreciation

- “Solely for purposes of paragraph (d)(1) of this section, a taxpayer may elect to treat as its depreciation deduction the amount that would result from using the straight-line method of depreciation over the class life (as defined by section 168(i)(1)…”
- Means taxpayer has the option to substitute straight-line depreciation for the disallowed portion of depreciation
- Disallowed depreciation is added back to the basis of the aircraft

§1.274-10 (d)(3)(i) Special rules for aircraft used for entertainment
Calculating the MACRS Depreciation Disallowance

- If Part 91 is the predominant use, use MACRS 5-year
- If Part 135 is the predominant use, use MACRS 7-year
- Reduce depreciation by the disallowance percentage
- Taxpayer has the option to convert the disallowed depreciation to straight line
- Report depreciation at gross amount on the Form 4562
- Adjust for percentage of disallowance and optional conversion to SL in workpapers
- Include depreciation adjustment along with the Sec. 274 adjustment line item in the “Other Expense” section of the income tax return
Calculating the Depreciation Disallowance

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation – MACRS 1\textsuperscript{st} year (20% of $5 million price)</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Disallowance Percentage</td>
<td>x20.5%</td>
</tr>
<tr>
<td>Disallowed MACRS before SIFL adjustment</td>
<td>205,000</td>
</tr>
<tr>
<td>Add-back SIFL portion (45% of Ent SIFL; see slide 67)</td>
<td>-20,385</td>
</tr>
<tr>
<td></td>
<td>184,615</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1\textsuperscript{st} Year Straight-Line Depr: $5M x 8.33%</td>
<td>416,500</td>
</tr>
<tr>
<td>Disallowance Percentage</td>
<td>x20.5%</td>
</tr>
<tr>
<td>Disallowed St-Line Depreciation before SIFL adjustment</td>
<td>85,383</td>
</tr>
<tr>
<td>Add-back SIFL portion (45% of Ent SIFL; see slide 67)</td>
<td>-20,385</td>
</tr>
<tr>
<td>Net Depreciation Disallowance</td>
<td>64,998</td>
</tr>
</tbody>
</table>
## Reporting the Entertainment Cost Disallowance on the Tax Return Supporting Schedule

<table>
<thead>
<tr>
<th>Expense</th>
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</tr>
</thead>
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</tr>
<tr>
<td>Hangar</td>
<td>45,000</td>
</tr>
<tr>
<td>1.274-10(e) Cost Adjustment</td>
<td>-231,335</td>
</tr>
<tr>
<td>1.274-10(e) Depreciation Adjustment</td>
<td>-64,998</td>
</tr>
<tr>
<td>Line 26 - Total Other Deductions</td>
<td>$327,962</td>
</tr>
</tbody>
</table>

Disallowed depreciation adds to basis at disposition.
Summary: Use of Straight-Line for Disallowed Depreciation

- Converting the disallowed depreciation to straight-line works best if the aircraft is at the beginning of the depreciation cycle.
- Disallowed depreciation is added back to the basis of the aircraft at disposition.
- Even fully depreciated aircraft will have basis remaining to offset gain at sale if there was entertainment use.

§1.274-10 (d)(3)(i) Special rules for aircraft used for entertainment
Disallowance Must Include All Costs - Even If In Separate Entities

- Individual 1040
- Aircraft Owning Entity
  - Depreciation, Interest Expense
- Dry Lease
- Operating Company
  - Direct Operating Costs, Pilot/Crew Costs, Insurance

Apply entertainment cost limitations to both entities
<table>
<thead>
<tr>
<th>Topic</th>
<th>SIFL Employee Income</th>
<th>Apply 274 Cost Disallowance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company Business Flights (Bucket #1)</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Other Business Flights (Bucket #2)</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Entertainment Flights (Bucket #3)</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Deadhead Flight</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Timeshare Flight – Employee</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Timeshare Flight – Non-Employee</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Schwab Flights</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Open Jaw Flights</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Fiscal Year Reporting (October 31)</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Calculate using all 4 methods, and compare</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Control &amp; Non-Control Employees</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Specified Individuals</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Bona Fide Security Plan</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Chartered or Leased Aircraft</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Commuting Flights</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>