

# *Tax reform proposals and methods of allocating expenses to personal entertainment flights*



This month's issue of Aircraft Club discusses the Chairman Camp's tax reform proposals related to business aircraft; and the methods a taxpayer may employ to allocate expenses to personal entertainment flights taken by specified individuals on employer-provided aircraft, both of which are noteworthy aircraft issues.

## ***Tax reform***

### ***Cruising altitude***

Chairman Camp's recently released comprehensive tax reform discussion draft calls for multiple changes that could potentially affect how taxpayers account for non-commercial aircraft used in their trade or business. The tax reform proposal was released on February 26,

2014. Comprehensive tax reform is not expected to be enacted this year; however, the Camp draft is likely to influence future tax reform efforts. In addition, there is concern that some provisions in the Camp draft could be 'cherry-picked' and proposed as offsets for the cost associated with other legislative priorities.

---

### *Stuck on the runway*

With regard to depreciation, currently taxpayers may include an aircraft, depending upon its primary use, either in asset class 00.21 of Rev. Proc. 87-56 (e.g., aircraft generally used in a taxpayer's business activities) classified as 5-year property under the GDS rules or asset class 45.0 (eg, aircraft used in commercial and contract carrying of passengers and freight) classified as seven-year property under the GDS rules.

Under the proposal, the depreciation method for tangible property is the straight line method and the applicable recovery period generally is the class life of the property. For all fixed wing aircraft, the class life would be 12 years. However, the recovery period for helicopters would remain unchanged and thus, would be classified as five-year property.

With regard to the entertainment disallowance rules, currently a taxpayer must limit the costs it may deduct when a 'specified individual' uses employer-provided aircraft for personal entertainment travel. Thus, the amount disallowed under Section 274 for an entertainment flight by a specified individual is the amount of the expenses allocable to such flight, reduced (but not below zero) by the amount the taxpayer treats as compensation or reports as income to the specified individual.

Under the proposal, the amount disallowed (as described above) to a taxpayer for costs incurred in providing an entertainment flight would be applicable to all employees who receive such a flight and not just too specified individuals.

With regard to the like-kind exchange rules of Section 1031, under the proposal, the provisions of the like-kind exchange rules allowing for deferral of gain on a qualified exchange would be repealed.

### *Landing*

If you have any questions in connection with Chairman Camp's tax reform proposals related to non-commercial aircraft, please call Rick Farley at (646) 471-4084 to discuss your questions in further detail.

## ***Methods of allocating expenses to personal entertainment flights***

### *Cruising altitude*

The amount disallowed under Section 274 for a personal entertainment flight by a specified individual is the amount of the expenses allocable to the entertainment flight by the specified individual, reduced (but not below zero) by the amount the taxpayer treats as compensation or reports as income to the specified individual. Any amount the specified individual reimburses the taxpayer for such entertainment use also is allowed to reduce the disallowed amount.

### *Stuck on the runway*

The final regulations provide two overall methods to allocate expenses to personal entertainment flights provided to specified individuals. Whichever method is chosen, the taxpayer must use the chosen method for all flights of all aircraft for the tax year. Thus, the taxpayer does have flexibility in choosing a particular method for a given year.

Under the occupied-seat method, a taxpayer may allocate expenses for each tax year using either occupied seat hours or occupied seat miles flown by the aircraft. In general, taxpayers must aggregate all fixed and variable expenses to determine the total expenses paid or incurred during the tax year and divide the amount of total expenses by total occupied seat hours or occupied seat miles flown to determine the cost per occupied seat hour or occupied seat mile in order to determine the amount of costs allocable to personal entertainment flights taken by specified individuals.

---

Alternatively, under the flight-by-flight method, a taxpayer may aggregate all expenses for the tax year and divide the amount of total expenses by the number of flight hours or miles for the taxable year to determine the cost per hour or mile. The taxpayer then allocates expenses to each flight by multiplying the number of miles or hours for the flight by the expense per hour or mile and allocates expenses for the flight to the passengers on the flight per capita to determine the amount of costs allocable to personal entertainment flights taken by specified individuals.

Whichever method of allocating expenses is used, the final regulations provide that the expense disallowance is to be applied on a pro rata basis to all disallowed expenses. In addition, it should be noted that special rules exist with regard to allocation of expenses related to mixed-use trips and deadhead flights.

As noted above, each year the taxpayer does have the flexibility to select either method (using either hours or miles). Consequently, taxpayers should calculate the deduction disallowance for entertainment flights by specified individuals by performing all four methods to determine which method results in the lowest disallowance amount.

Since the disallowance is permanent in nature, the deduction calculation is not a method of accounting. Thus, a taxpayer need not request permission to change use of methods year to year.

### *Landing*

If you have any questions in connection with the deduction disallowance methods, please call Rick Farley to discuss your questions in further detail.

### *Let's talk*

For a deeper discussion of how this issue might affect your business, please contact:

Rick Farley, *New York*

+1 (646) 471-4084

[richard.c.farley@us.pwc.com](mailto:richard.c.farley@us.pwc.com)