

Publications

Proposed IRS Regulations on Entertainment Use of Business Aircraft

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The IRS recently issued proposed regulations under Code section 274(e)(2) (and 274(e)(9)) on deducting entertainment use of an employer's aircraft by specified individuals officers, directors, more than 10% owners and their family members. 72 Fed. Reg. 33169 (June 15, 2007).

In general, entertainment expenses are not deductible unless they are directly related to (or associated with) the active conduct of the employer's trade or business. Code section 274(e)(2) provides an exception for amounts treated as compensation to the employee, but (since the law changed effective October 22, 2004) the maximum deduction of employer's expenses cannot exceed the compensation imputed for a specified individual. To calculate this imputed compensation for entertainment flights, employers can either use the general or special valuation rules. Under the general approach, a taxpayer uses the fair market value of the flight based on an arms-length charter of same or comparable aircraft for the same or comparable flight (or if no pilot, rental of comparable aircraft). Under the special rule, a taxpayer uses the "SIFL" rate under Treas. Reg. § 1.61-21(g). To calculate the employer's deductible entertainment expenses for specified individuals, Notice 2005-45 clarifies who is covered and the relevant costs, and illustrates the allocation of costs for an entertainment flight.

Despite commentators request for relief in various areas, the proposed regulations largely track the interim guidance in Notice 2005-45, described below, taking a hard line on most issues. However, a few provisions would give employers additional flexibility including the new flight-by-flight allocation approach and depreciation method, and floating a possible charter safe harbor rule.

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