

WELCOME




**Rules for Reporting Entertainment
Flight Cost Limitations**

July 09, 2015

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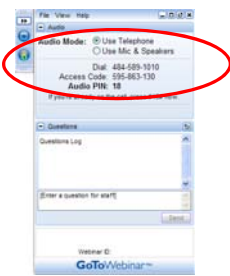


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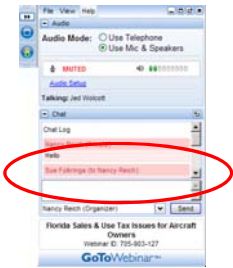
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- Course materials have been emailed to you but in case you do not have them:
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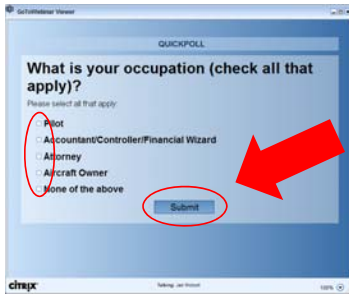


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Upcoming Webinar Events

- July 16, 2015 IRS Tax Consequences from Selling Your Aircraft

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IRS Rules for Calculating and Reporting the Company Cost Limitations from Entertainment Passengers on Employer-Provided Aircraft

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Entertainment Cost Disallowance Rules

- Entertainment cost disallowance rules apply to passengers on *Employer-Provided Aircraft*
- Applies to aircraft owned by entities with employees
- The rules are applied on a *Per-Capita* basis
- The owner must classify and document every passenger on every flight leg
- Applies to fully-owned aircraft, leased aircraft, fractional aircraft, or chartered aircraft

30300

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Entertainment Cost Disallowance Rules



- Overall objective is to develop an annual percentage of entertainment passenger use that will reduce costs, expenses and depreciation of the aircraft for tax reporting
- Disallowing costs increases taxable income, and the company pays more income tax
- Entertainment passengers create additional income taxes for the company (or the company's owners)

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13

Topics for Today's Presentation



- Review Specific rules in Reg. Sec. 1.274-10 for making the disallowance calculation
- Tracking and Calculating Flights and Passengers
- Making the year-end disallowance calculation

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14


Entertainment Disallowance Rules



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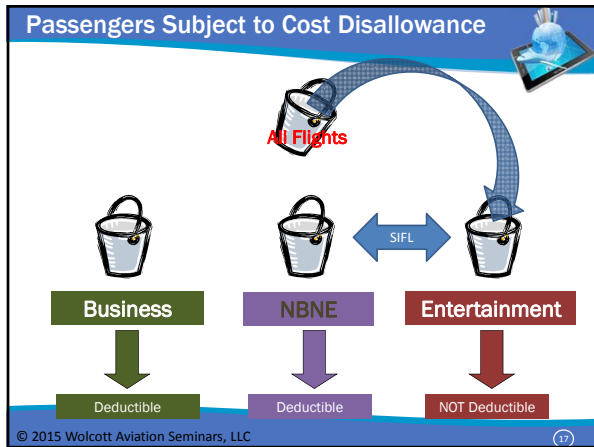
15

Passengers Classifications


10800 

- **Business passengers:** These passenger flight costs are fully deductible
- **Non-Business Non-Entertainment passengers:** (called NBNE). These are passengers that are:
 - On business, but not the business of the company that owns the aircraft, or
 - Non-business passengers that do not have an entertainment component
 - Pro rata flight costs are deductible
- **Entertainment passengers:** These are passengers on the aircraft for an entertainment purpose
 - Pro rata flight costs are NOT deductible

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Costs Subject To Disallowance

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(IRS definition): 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
- Meal and lodging expenses of flight personnel
- Take-off and landing fees
- Costs for maintenance or deadhead flights
- Costs of on-board refreshments, amenities and gifts
- Hangar fees (at home or away)
- Management fees
- Costs of fuel, tires, insurance, registration, inspections
- Depreciation
- Interest on debt secured by or properly allocated (within the meaning of §1.163-8T) to the aircraft
- All costs paid or incurred for aircraft leased or chartered to the taxpayer

1.274-10(d)(1)

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Specified Individual

- A Specified Individual must be present to make passengers subject to the entertainment rules
- Includes every officer, director and beneficial owner of more than 10% of any class of any equity security
- IRC §274(e)(2)(B) defines "Specified Individual" by reference to section 16(a) of the Securities Exchange Act of 1934
 - Not limited to public companies
- **If there is no Specified Individual associated with a flight, there is no entertainment disallowance, even if the passengers engage in entertainment activities**

10304

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What Is Entertainment?

- Entertainment, Amusement or Recreation
 - "Entertainment" means any activity which is generally considered to constitute entertainment, amusement or recreation: Treas. Reg. 1.274-2(b)(1) 10304
 - "Entertainment use is an amusement or recreational activity, such as traveling to a sporting event or a vacation destination" Notice 2005-45 10307
 - An activity not "directly related to" or "associated with" the active conduct of a trade or business

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Examples of Entertainment

- IRS states attending nightclubs, cocktail lounges, theatres are examples of entertainment activities
- Country clubs, golf and athletic clubs, sporting events, hunting, fishing, and vacations are all entertainment activities
- Facts and circumstances may determine if an activity is entertainment; attending a theatrical performance would generally be entertainment, unless the taxpayer was a professional theater critic
- Entertainment is often described as a frame of mind...passenger expects enjoyment after flight

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Examples Of Non-Entertainment:



- Attending to business that is not the business of the company that owns the aircraft
- Attending a meeting of the Board of Directors of an unrelated company
- Charitable flights, such as Angel Flights
- Routine personal activities 60110

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Routine Personal Activities are not Entertainment



- Commuting flights
- Flights with investment advisor, attorney, accountant
- Flight to take child to boarding school or college
- Flights to visit employee's parents or relatives
- Flight to attend funeral
- Key is lack of entertainment, not "routine" nature of the activity

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Spousal Travel



- Spouses traveling for business are judged to a higher standard
- IRS will always consider a spouse to be an entertainment passenger
- Treating a spouse as NBNE requires substantial documentation
- Spouse must be a W-2 employee for consideration as a business passenger, and have a documentable business reason to be on the flight

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Commuting Flights



- Commuting flights follow the Tax Home rules for employees
- Commuting flights are generally NBNE for the employee
 - This means charge SIFL to the employee
 - Cost is deductible to the company
- Treat spouse and children normally (NBNE or entertainment)
- If there are multiple homes, the IRS will generally allow commuting only to the nearest home
- If the employee claims business for a flight to a second home because they worked while there, the IRS will reclassify flight to be commuting if the employee merely performed routine work usually done in the office

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Deadhead Flights



- Deadhead flights are flights with no passengers
- Deadhead flights must be treated as passenger flights for calculating the entertainment disallowance
- "Passengers" are "ghosted" and classified according to the previous or subsequent passengers for the flights they are associated with

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Open Jaw Flights



- Flights with a combination of business and entertainment legs plus a return leg
- The return leg may be pro-rated in favor of the taxpayer by giving credit to the business passengers first, then accounting for the entertainment passengers
- Report the flight as though only the business portion was flown, then count the remaining hours and miles as entertainment
- Identifying and reporting Open Jaw flights will reduce the disallowance and reduce taxes

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Use of Straight-Line for Disallowed Depreciation

- If the taxpayer is reporting accelerated depreciation, the IRS allows the taxpayer to reclass depreciation that is disallowed by entertainment flights
- The depreciation that is disallowed by entertainment flights may be converted to straight line depreciation, reducing the disallowance
- This is a “taxpayer-favorable” adjustment that should not be overlooked
- Disallowed depreciation is suspended until the aircraft is sold or traded

§1.274-10 (d)(3)(i) Special rules for aircraft used for entertainment 10302

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Disallowance vs. Reimbursement

- The Entertainment disallowance is reduced by SIFL or reimbursements from entertainment passengers
- If imputed income (SIFL) or reimbursement equals the total cost of the flight, no disallowance
- If imputed income (SIFL) or reimbursement is less than the cost of the flight, disallow the difference
- Reimbursements are subject to FET

(Cost includes operating costs, ownership costs, interest and depreciation)

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Tracking and Calculating Flights and Passengers

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Tracking and Calculation Methods

- Tracking and recording manually with a spreadsheet
 - Low cost
 - User must know rules and formulas
 - We publish a guide to using spreadsheets at www.aviation-cpa.com
- Software
 - More expensive than spreadsheets
 - Automated, so user is not required to know the rules and formulas
 - Flight Tax Systems at www.flighttaxsystems.com

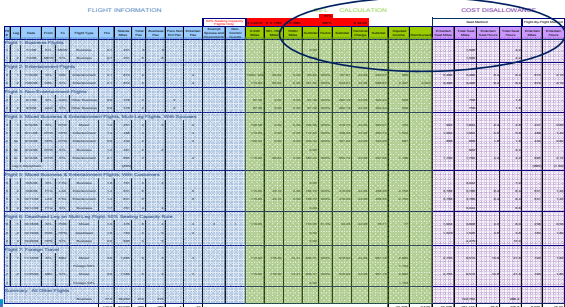
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Four Cost Disallowance Formulas 10300

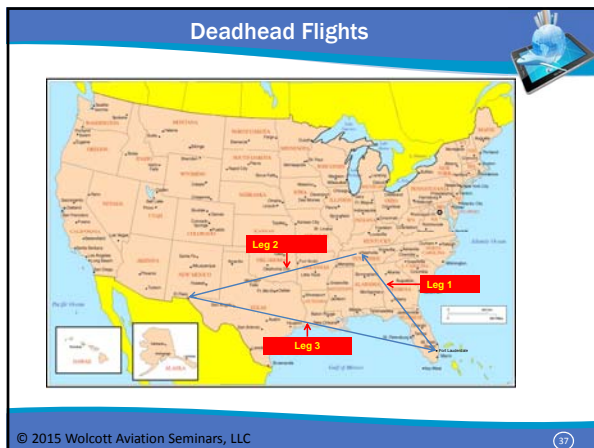
- There are 4 methods for calculating cost disallowance:
 - Occupied seat miles 10150
 - Occupied seat hours 10351
 - Flight-by-flight miles 10352
 - Flight-by-flight hours 10353
- Taxpayer is allowed to use the calculation method that results in the lowest tax
- (i.e., the lowest percentage of disallowance)

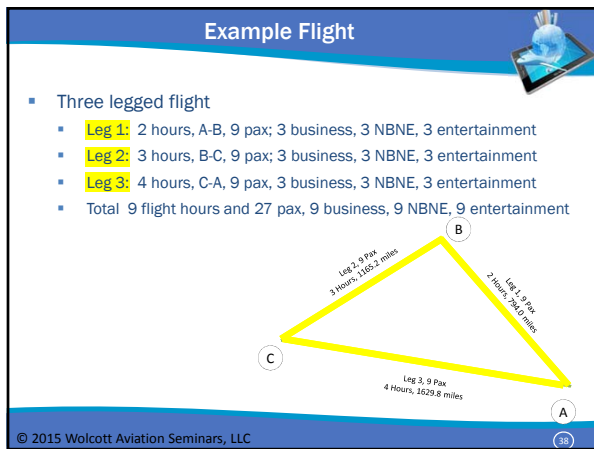
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Excel Spreadsheet Reporting



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Flight Tax Systems, LLC

ACCOUNT HOME RETURN TO REPORTS PRINT REPORT LOGOUT

Report Name: Cost Disbursement Report Owner: Demo Client

Date	Airway	Flight #	Lag	Depart	Arrive	Flight Status	Total Miles	Bus Pax	NBNE Pax	Ent Pax	Seat Miles Calculation			Seat Hours Calculation			Flights by Flight Calculation			Notes			
											Total Seat Miles	Non-Ent Seat Miles	Ent Seat Miles	Total Seat Hours	Non-Ent Seat Hours	Ent Seat Hours	Bus Miles	NBNE Miles	Ent Miles		Bus Hours	NBNE Hours	Ent Hours
04/09/2015	N1234	000000	1	MFL	ADNA	2	794.0	9	3.0	3.0	3.0	2,140.0	4,714.0	3,362.0	10	0	204.7	204.7	0.7	0.7	0.7		
04/09/2015	N1234	000000	2	MFL	KJLJ	3	1,165.2	9	3.0	3.0	3.0	10,480.0	9,097.2	3,476.0	27	0	388.4	388.4	204.4	1.0	1.0	1.0	
04/09/2015	N1234	000000	3	KJLJ	MFL	4	1,029.8	9	3.0	3.0	3.0	14,000.0	9,274.8	4,096.2	36	0	342.0	342.0	264.0	1.0	1.0	1.0	
Totals:							9	9,989.0				35,620.0	23,086.0	10,954.2	73	0	935.1	935.1	573.4	3.0	3.0	3.0	
												86.7%	83.9%				86.7%	83.9%	83.9%	83.9%	83.9%	83.9%	

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Deadhead Flight Example

- Three legged flight
 - Leg 1: 2 hours, A-B, 12 pax, 8 business, 4 entertainment
 - Leg 2: 3 hours, B-C, deadhead (requires "ghosted" passengers)
 - Leg 3: 4 hours, C-A, 12 pax, 6 business, 6 entertainment
 - Total 9 flight hours and 24 pax, 14 business, 10 entertainment

To Do:

1. Determine which leg caused the deadhead
2. Record "ghost" passengers from that flight

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Deadhead Flight Example

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 FORT LAUDERDALE, FLORIDA 33304

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Report Name: Cost Disallowance Report Owner: Dennis Clark

Date	Aircraft	Flight #	Leg #	Depart	Arrive	Status Miles	Total Pass	NBSE Pass	Ent Miles	Seat Miles Calculation		Seat Hours Calculation		Flights-by-Flight Calculation				Notes				
										Total Seat Miles	Ent Seat Miles	Total Seat Hours	Ent Seat Hours	Bus	NBSE	Ent	Bus		NBSE	Ent		
04/06/2015	N12347	888887	1	MFL	KONA	2	794.0	1	0.0	0.0	794.0	794.0	0.0	2	2	0	794.0	0	0	0	0	
04/06/2015	N12347	888887	2	KONA	KEFL	3	1,102.2	1	0.0	0.0	1,102.2	0.0	1,102.2	3	0	3	0	0	0	0	0	3.0
04/06/2015	N12347	888887	3	KEFL	MFL	4	1,620.0	1	0.0	0.0	1,620.0	0.0	1,620.0	4	0	4	0	0	0	0	0	4.0
Totals:										3,516.2	794.0	3,516.2	9	2	7	794.0	0.0	2,794.1	2.0	0.0	7.0	
										22.1%	77.9%		22.2%	77.8%	22.1%	0.0%	77.9%	22.2%	0.0%	77.8%		

↑ ↑ ↑ ↑

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Report Name: Open Jaw Report Owner: Dennis Clark

Flight Date	Aircraft	Flight #	Leg #	Depart	Arrive	Miles	Hours	NBSE Pass	Ent Pass	Status
04/06/2015	N12347	888887	3	KEFL	MFL	1,620.0	0.0	0.0	0.0	Priority

The legs below were part of the flight that you selected.

Flight Date	Aircraft	Flight #	Leg #	Depart	Arrive	Miles	Hours	NBSE Pass	Ent Pass
04/06/2015	N12347	888887	2	KONA	KEFL	1,102.2	0.0	0.0	0.0
04/06/2015	N12347	888887	3	KEFL	MFL	1,620.0	0.0	0.0	0.0

The next step is to break the highlighted flight leg into 2 parts.

Flight Date	Aircraft	Flight #	Leg #	Depart	Arrive	Miles	Hours	NBSE Pass	Ent Pass
04/06/2015	N12347	888887	3a	KEFL	MFL	413.0	0.0	0.0	0.0
04/06/2015	N12347	888887	3b	MFL	MFL	1,207.0	0.0	0.0	0.0

Remaining: 0.0 Miles, 0.0 Hours

Open Jaw Leg
 Split Open Jaw into 2 Parts

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Report Name: Cost Disallowance Report Owner: Dennis Clark

Date	Aircraft	Flight #	Leg #	Depart	Arrive	Status Miles	Total Pass	NBSE Pass	Ent Miles	Seat Miles Calculation		Seat Hours Calculation		Flights-by-Flight Calculation				Notes				
										Total Seat Miles	Ent Seat Miles	Total Seat Hours	Ent Seat Hours	Bus	NBSE	Ent	Bus		NBSE	Ent		
04/06/2015	N12347	888887	1	MFL	KONA	2	794.0	1	0.0	0.0	794.0	794.0	0.0	2	2	0	794.0	0	0	0	0	
04/06/2015	N12347	888887	2	KONA	KEFL	3	1,102.2	1	0.0	0.0	1,102.2	0.0	1,102.2	3	0	3	0	0	0	0	0	3.0
04/06/2015	N12347	888887	3a	KEFL	MFL	413.0	1	0	0	0	1,588.0	0.0	2	2	0	1,588.0	0	0	0	0	0	2.0
04/06/2015	N12347	888887	3b	MFL	MFL	1,207.0	1	0	0	0	1,207.0	0.0	2	2	0	1,207.0	0	0	0	0	0	2.0
Totals:										3,516.2	794.0	3,516.2	9	0	6	2,794.1	0.0	2,794.1	4.0	0.0	7.0	
										68.4%	23.6%		44.4%	55.6%	68.4%	0.0%	33.6%	44.4%	0.0%	55.6%		

Costs Found in Notes:
 0 - Flight with an open jaw leg

After Adjustment 68.4% 23.6% 44.4% 55.6% 68.4% 0.0% 33.6% 44.4% 0.0% 55.6%

Before Adjustment 77.9% 22.1% 77.8% 22.2%

Savings 8.5% 22.2% 8.5% 22.2%


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Year-End Reporting


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Calculating the Disallowance

- Step 1: Analyze flights for entertainment passengers
- Step 2: Calculate entertainment cost limitation percentage for the year
- Step 3: Calculate straight-line depreciation adjustment
- Step 4: Add direct operating costs and ownership costs and apply the disallowance percentage, add back the depreciation adjustment and the SIFL imputed income

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Calculating the Disallowance

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58

Example Company



- Purchased aircraft for \$10,000,000
- Direct Operating Costs \$600,000
- Ownership Costs \$1,000,000
- Depreciation (first year @ 20%) \$2,000,000
- Entertainment SIFL \$31,308
- Entertainment disallowance percentage 12.37%

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Calculating the Disallowance (con't)



Category	Amount	Amount
Direct Operating Costs		600,000
Ownership Costs		1,000,000
Depreciation		2,000,000
Add for Total Cost		3,600,000
Multiply by Entertainment Use %		12.37%
Subtotal		445,320
Subtract Depreciation Adjustment to Straight Line		-144,358
Subtotal		300,962
Credit for SIFL imputed income or reimbursement- Deduct the greater of:		
Entertainment SIFL, or	-31,308	
Reimbursement		-31,308
Net Costs Disallowed		269,654

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60
