

## Federal Tax Regulations (TRC Version), Proposed-regulation, **1.274-10, Special rules for aircraft used for entertainment**

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**Business Deduction: Entertainment Expense: Business Aircraft.**—Reg. §§1.274-9 and 1.274-10, relating to the use of business aircraft for entertainment and affecting taxpayers that deduct expenses for entertainment, amusement or recreation provided to specified individuals, are proposed (published in the Federal Register on June 15, 2007) (REG-147171-05) (corrected July 12, 2007).

# Par. 4. Section 1.274-10 is added to read as follows:

### **§1.274-10. Special rules for aircraft used for entertainment**

#### **(a) Use of an aircraft for entertainment**

**(1) In general.**— Under section 274(a) and this section, no deduction otherwise allowable under chapter 1 is allowed for expenses for the use of a taxpayer-provided aircraft for entertainment, except as provided in paragraph (a)(2) of this section.

#### **(2) Exceptions**

**(i) In general.**— Paragraph (a)(1) of this section does not apply to deductions for expenses for business entertainment air travel or to deductions for expenses that meet the exceptions of section 274(e), §1.274-2(f), and this section.

#### **(ii) Expenses treated as compensation**

**(A) Employees.**— Section 274(a), paragraphs (a) through (d) of §1.274-2, and paragraph (a)(1) of this section, in accordance with section 274(e)(2), do not apply (in the case of specified individuals, as provided in paragraph (a)(2)(ii)(C) of this section), to expenses for entertainment air travel provided to employees to the extent that a taxpayer—

- (1)** Properly treats the expenses with respect to the recipient of entertainment as compensation to an employee under chapter 1 and as wages to the employee for purposes of chapter 24; and
- (2)** Includes the proper amount in the employee's income under §1.61-21.

**(B) Persons who are not employees.**— Section 274(a), paragraphs (a) through (e) of §1.274-2, and paragraph (a)(1) of this section, in accordance with section 274(e)(9), do not apply (in the case of specified individuals, as provided in paragraph (a)(2)(ii)(C) of this section), to expenses for entertainment air travel provided to persons who are not employees to the extent the expenses are includible in the income of those persons. This exception does not apply to any amount paid or incurred by the taxpayer that is required to be included in any information return filed by the taxpayer under part III of subchapter A of chapter 61 and is not so included.

**(C) Specified individuals.**— Section 274(a) and paragraphs (a) through (d) of §1.274-2, in accordance with section 274(e)(2)(B), do not apply to expenses for entertainment air travel of a specified individual to the extent that the expenses do not exceed the sum of—

- (1)** The amount treated as compensation under paragraph (a)(2)(ii)(A) of this section or reported as income under paragraph (a)(2)(ii)(B) of this section to the specified individual; and
- (2)** Any amount the specified individual reimburses the taxpayer.

**(b) Definitions.**— The definitions in this paragraph (b) apply for purposes of this section.

example, section 168). If the property is qualified property or 50-percent bonus depreciation property under section 168(k), qualified New York Liberty Zone property under section 1400L(b), or qualified Gulf Opportunity Zone property under section 1400N(d), depreciation for purposes of this straight-line election is determined on the unadjusted depreciable basis of the property. For purposes of this section, a taxpayer that elects to use the straight-line method and class life under this paragraph (d)(3) for any aircraft it operates must use that method for all taxpayer-provided aircraft it operates and must continue to use the method for the entire period the taxpayer uses any taxpayer-provided aircraft.

**(ii) Aircraft placed in service in earlier taxable years.**— If the taxpayer elects to use this paragraph (d)(3) with respect to aircraft placed in service in taxable years before the current taxable year, the amount of depreciation is determined by applying the straight-line method of depreciation to the original cost (or, for property acquired in an exchange to which section 1031 applies, the basis of the aircraft as determined under section 1031(d)) and over the class life (taking into account the applicable convention under section 168(d)) of the aircraft as though the taxpayer used that methodology from the year the aircraft was placed in service.

**(iii) Manner of making and revoking election.**— A taxpayer makes the election under this paragraph (d)(3) by filing an income tax return for the taxable year that determines the taxpayer's expenses for purposes of paragraph (d)(1) of this section by including depreciation as determined under this paragraph (d)(3). An election may be revoked only for compelling circumstances upon consent of the Commissioner by private letter ruling.

#### **(4) Aggregation of aircraft**

**(i) In general.**— A taxpayer may aggregate the expenses of aircraft of similar cost profiles for purposes of calculating disallowed expenses under paragraph (c) of this section.

**(ii) Similar cost profiles.**— Aircraft are of similar cost profiles if their operating costs per mile or per hour of flight are comparable. Aircraft must have the same engine type (jet or propeller) and the same number of engines to have similar cost profiles. Other factors to be considered in determining whether aircraft have similar cost profiles include, but are not limited to, payload, passenger capacity, fuel consumption rate, age, maintenance costs, and depreciable basis.

#### **(e) Allocation of expenses**

**(1) General rule.**— For purposes of determining the expenses allocated to entertainment air travel of a specified individual under paragraph (a)(2)(ii)(C) of this section, a taxpayer must use either the occupied seat hours or miles method of paragraph (e)(2) of this section or the flight-by-flight method of paragraph (e)(3) of this section. A taxpayer must use the chosen method for all flights of all aircraft for the taxable year.

#### **(2) Occupied seat hours or miles method**

**(i) In general.**— The occupied seat hours or miles method determines the amount of expenses allocated to a particular entertainment flight of a specified individual based on the occupied seat hours or miles for an aircraft for the taxable year. Under this method, a taxpayer may choose to use either occupied seat hours or miles for the taxable year to determine the amount of expenses allocated to entertainment flights of specified individuals, but must use occupied seat hours or miles consistently for all flights for the taxable year.

**(ii) Computation of the occupied seat hours or miles method.**— The amount of expenses allocated to an entertainment flight taken by a specified individual is determined under the occupied seat hours or miles method by—

(A) Determining the total expenses for the year under paragraph (d)(1) of this section for the aircraft or group of aircraft (as determined under paragraph (d)(4) of this section), as applicable;

(B) Determining the total number of occupied seat hours or miles for the taxable year for the aircraft or group of aircraft by totaling the occupied seat hours or miles of all flights in the taxable year flown by the aircraft or group of aircraft, as applicable. The occupied seat hours or miles for a flight is the number of hours or miles flown for the flight multiplied by the number of seats occupied on that flight. For example, a flight of six hours with three passengers results in 18 occupied seat hours;

(C) Determining the cost per occupied seat hour or mile for the aircraft or group of aircraft, as applicable, by dividing the total expenses in paragraph (e)(2)(ii)(A) of this section by the total number of occupied seat hours or miles determined in paragraph (e)(2)(ii)(B) of this section; and

(D) Determining the amount of expenses allocated to an entertainment flight taken by a specified individual by multiplying the number of hours or miles of the flight by the cost per occupied hour or mile for that aircraft or group of aircraft, as applicable, as determined in paragraph (e)(2)(ii)(C) of this section.

**(iii) Allocation of expenses of multi-leg trips involving both business and entertainment legs.**— A taxpayer that uses the occupied seat hours or miles allocation method must allocate the expenses of a trip by a specified individual that involves at least one segment for business and one segment for entertainment purposes between the business travel and the entertainment travel unless none of the expenses for the entertainment segment are disallowed. The entertainment cost of a multi-leg trip is the total cost of the flights (by occupied seat hours or miles) over the cost of the flights that would have been taken without the entertainment segment or segments.

**(iv) Examples.**— The following examples illustrate the provisions of this paragraph (e)(2):

*Example 1.* (i) A taxpayer-provided aircraft is used for Flights 1, 2, and 3, of 5 hours, 5 hours, and 4 hours, respectively, during the Taxpayer's taxable year. On Flight 1, there are four passengers, none of whom are specified individuals. On Flight 2, passengers A and B are specified individuals traveling for entertainment purposes and passengers C and D are not specified individuals. Taxpayer treats \$1,200 as compensation to A, and B reimburses Taxpayer \$500. On Flight 3, all four passengers (A, B, E, and F) are specified individuals traveling for entertainment purposes. The Taxpayer treats \$1,300 each as compensation to A, B, E, and F. Taxpayer incurs \$56,000 in expenses for the operation of the aircraft for the taxable year. The aircraft is operated for 56 occupied seat hours for the period (four passengers times 5 hours or 20 occupied seat hours for Flight 1, plus four passengers times 5 hours or 20 occupied seat hours for Flight 2, plus four passengers times 4 hours or 16 occupied seat hours for Flight 3). The cost per occupied seat hour is \$1,000 (\$56,000/56 hours).

(ii) For purposes of determining the amount disallowed (to the extent not treated as compensation or reimbursed), \$5,000 ( $\$1,000 \times 5$  hours) each is allocable with respect to A and B for Flight 2, and \$4,000 ( $\$1,000 \times 4$  hours) each is allocable with respect to A, B, E, and F for Flight 3.

(iii) For Flight 2, because Taxpayer treats \$1,200 as compensation to A, and B reimburses Taxpayer \$500, Taxpayer may deduct \$1,700 of the cost of Flight 2 allocable to A and B. The deduction for the remaining \$8,300 cost allocable to entertainment provided to A and B on Flight 2 is disallowed (with respect to A, \$5,000 less the \$1,200 treated as compensation, and with respect to B, \$5,000 less the \$500 reimbursed).

(iv) For Flight 3, because Taxpayer treats \$1,300 each as compensation to A, B, E, and F, Taxpayer may deduct \$5,200 of the cost of Flight 3. The deduction for the remaining \$10,800

cost allocable to entertainment provided to A, B, E, and F on Flight 3 is disallowed (\$4,000 less the \$1,300 treated as compensation to each specified individual).

*Example 2.* (i) G, a specified individual, is the sole passenger on an aircraft on a two-hour flight from City A to City B for business purposes. G then travels on a three-hour flight from City B to City C for entertainment purposes, and returns from City C to City A on a four-hour flight. G's flights have resulted in nine occupied seat hours (two for the first segment, plus three for the second segment, plus four for the third segment). If G had returned directly to City A from City B, the flights would have resulted in four occupied seat hours.

(ii) Under paragraph (e)(2)(iii) of this section, five occupied seat hours are allocable with respect to G's entertainment (nine total occupied seat hours minus the four occupied seat miles that would have resulted if the travel had been a roundtrip business trip without the entertainment segment). If Taxpayer's cost per occupied seat hour for the year is \$1,000, \$5,000 is allocated with respect to G's entertainment use of the aircraft (\$1,000 × five occupied seat hours). The amount disallowed is \$5,000 minus any amount the Taxpayer treats as compensation to G or that G reimburses Taxpayer.

### **(3) Flight-by-flight method**

**(i) In general.**— The flight-by-flight method determines the amount of expenses allocated to a particular entertainment flight of a specified individual on a flight-by-flight basis by allocating expenses to individual flights and then to a specified individual traveling for entertainment purposes on that flight.

**(ii) Allocation of expenses.**— A taxpayer using the flight-by-flight method must aggregate all expenses (as defined in paragraph (d)(1) of this section) for the taxable year for the aircraft or group of aircraft (as determined under paragraph (d)(4) of this section), as applicable, and divide the total amount of expenses by the number of flight hours or miles for the taxable year for that aircraft or group of aircraft, as applicable, to determine the cost per hour or mile. Expenses are allocated to each flight by multiplying the number of miles or hours for the flight by the cost per hour or mile. The expenses for the flight are then allocated to the passengers on the flight per capita. Thus, if three of five passengers are traveling for business and two passengers are specified individuals traveling for entertainment purposes, and the total expense allocated to the flight is \$10,000, the expense allocable to each specified individual is \$2,000.

### **(f) Special rules**

**(1) Determination of basis.**— If an amount disallowed is allocable to depreciation under paragraph (f)(2) of this section, the rules of §1.274-7 apply. In that case, the basis of an aircraft is not reduced for the amount of depreciation disallowed under this section.

**(2) Pro rata disallowance.**— The expense disallowance provisions of this section are applied on a pro rata basis to all of the expenses disallowed by this section.

### **(3) Deadhead flights**

**(i)** For purposes of this section, an aircraft returning without passengers after discharging passengers or flying without passengers to pick up passengers (deadheading) is treated as having the same number and character of passengers as the leg of the trip on which passengers are aboard for purposes of the allocation of expenses under paragraphs (e)(2) or (e)(3) of this section. For example, when an aircraft travels from point A to point B and then back to point A, and one of the legs is a deadhead flight, for determination of disallowed expenses, the aircraft is treated as having made both legs of the trip with the same passengers aboard for the same purposes.

**(ii)** When a deadhead flight does not occur within a roundtrip flight, but occurs between two unrelated flights involving more than two destinations (such as an occupied flight from point A to point B, followed by a deadhead flight from point B to point C, and then an occupied flight