



New IRS Regulations Liberalize Deduction Limitation for Entertainment Use of Aircraft

The Internal Revenue Service has issued proposed regulations on an employer's restricted deductions for aircraft entertainment use by specified individuals. The regulations follow the general approach provided in Notice 2005-45; however, they provide certain significant election opportunities, and hint of more to come. Highlights of the regulations include the following:

1. The disallowance rules only apply to specified individuals, their family, or other individuals attributable to them. A specified individual is generally a 10% owner of a corporation or a partnership, an officer, or an individual holding a similar position in a related entity.
2. Expenses subject to disallowance only include entertainment use by specified individuals; non-entertainment use by specified individuals, and entertainment use by non-specified individuals remains exempt from disallowance computations.
3. There is a simplification in the computations under the occupied seat rule. Notice 2005-45 required a computation involving occupied seats of both business and non-business flights. Under the new rules, there is a new option that allows for computation of expenses on a flight-by-flight basis and a per capita computation for partially disallowed deductions.
4. Trips involving both business and pleasure without repositioning the aircraft that are primarily business in nature will not require an allocation. Trips where the aircraft is repositioned will be subject to disallowance based on an allocation method that denies incremental cost based on marginal flight time.
5. The regulations clarify that the deductions do not apply to any disallowance for business entertainment that meets the "directly related" or "associated with" test that qualify as deductible business entertainment.
6. The regulation introduces a new optional depreciation calculation that is used solely for the purpose of determining the deduction disallowance for applicable entertainment flights. Although there is a consistency requirement for calculation of the disallowance under this section, it does not deprive a taxpayer of the use of accelerated depreciation for regular tax purposes.

7. The regulation did not provide any further guidance as to what constitutes entertainment, and specifically refers to existing regulations in the area. The regulation also refuses to address integration of existing entertainment facility rules with these new changes in the law.
8. The regulation states that the issue relating to charging specified individuals is outside the scope of these proposed regulations. However the preamble states that the fair market value exception was designed to be limited to those in the business of providing entertainment to customers.
9. The regulations also state that the Service is considering an alternative method of determining expenses subject to disallowance derived from a charter rate. Under this safe-harbor method, taxpayers could elect to treat as the amount of expenses for entertainment flights an amount equal to a fair market value charter rate. The proposed regulations do not include a safe harbor at this time, and taxpayers may not use the charter rate to determine expenses unless and until a rule is adopted in the final regulations.

The regulations as proposed apply to any taxable year beginning on or after the date of the publication of the Treasury decision adopting the rules as final regulations. However, taxpayers may rely on the rules in the proposed regulations before the publication of the Treasury decision. The proposed regulations offer some relief, and significant planning opportunities in the form of irrevocable tax elections. The first opportunity to take advantage of these elections for most taxpayers will occur as early as October 2007.

These changes in the regulations add significant complexity to an already burdensome area of the law. We will be conducting a series of webinars designed to educate our clients, their advisors, and our friends on both the complexity and the opportunities available under these new rules. The seminars will be customized based on both the size of the aircraft and whether or not they are owner flown or professionally flown. Please register for our email updates to receive the announcement and invitation information - <http://www.advocatetax.com/updatesList.php>.

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