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Leaving on a Jet Plane -- And Related Fringe Benefit Issues

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Summary Overview

- Personal Use of Corporate Aircraft
  - Tax treatment
  - SEC disclosure rules
  - Spousal/family accompaniment rules
  - “Time-sharing” agreements

Personal Use of Corporate Aircraft: General Rules

- Personal use of corporate aircraft has value to the employee
  - This value is provided in connection with employment, and therefore:
    - Under IRC Section 61(a)(1), the "value" is includible in the employee's income as a taxable fringe benefit
    - Under SEC rules, the "aggregate incremental cost" to the company must be disclosed to shareholders in the company's annual proxy for reportable executives (CEO, CFO +3 other highest-paid officers)
- IRS and SEC rules have different purposes – and so the calculations are different.
  - IRS rules look at the value provided to the employee
  - SEC rules want shareholders to know what it is costs the company to provide that benefit
  - For example, the same cross-country flight might be treated as follows:
    - Employee is taxed on imputed income of $1700.
    - Proxy could report that the employee received a perquisite with a value of approximately $30,000.

Personal Aircraft Use: Tax Rules

- Treas. Reg. 1.61-21(g): Noncommercial flight valuation rule
  - Companies can value personal usage of aircraft in two ways:
    - Comparable charter price on a comparable aircraft
    - SIFL method: "Standard industry fare level" valuation method
  - SIFL most always produces a lower rate, and so is the more commonly used valuation method
- SIFL Method: Treas. Reg. 1.61-21(g)(5):
  - The value of noncommercial flights on employer-provided aircraft that is subject to taxation as a fringe benefit is determined by multiplying SIFL cents-per-mile rates applicable for the period during which the flight was taken by the appropriate aircraft multiple (1.61-21(g)(7)), and then adding the applicable terminal charge

Personal Aircraft Use: SIFL Rates

- SIFL rates are published semi-annually by the IRS
    - Most recently: Rev. Rul. 2015-20 (Sept. 21, 2015)
  - For flights taken July 1 – December 31:
    - 23.41 cents/mile up to 500 miles
    - 17.85 cents/mile from 501 to 1500 miles
    - 17.16 cents/mile in excess of 1500 miles
    - Terminal charge is $42.79
  - Aircraft multiples are based on "maximum certified take-off weight of the aircraft"
    - 6000 lbs. or less: 62.5%
    - 6001 – 10,000 lbs.: 125%
    - 10,001 – 25,000 lbs.: 300%
    - 25,001 lbs. or more: 400%
- <u>Doing the math</u>: 3000 mile flight on aircraft weighing 20,000 lbs. results in imputed income to executive of ~$1700.00
  - If the executive has family members or guests accompany her, the executive has the same amount of income ($1700 in this example) imputed to her for each family member and guest (Employee + 3 guests = ($1700 x 4))
  - <u>Note</u>: If 50% of seats are occupied by individuals who are primarily on the plane for business reasons, then there is no income imputed to those employees/family members

Personal Aircraft Use: Proxy Disclosures

- SEC rules require disclosure of the value of any "perquisites" provided to executives
  - Personal aircraft usage requires calculation of the "aggregate incremental cost"
    - That is, what costs does the company incur in order to provide the flight to the employee (and his/her guests)
      - Includes flight crew, fuel, allocable maintenance fees, catering etc.
    - There are services that produce an average hourly cost of operating each particular type of aircraft
      - Company cost typically runs between $4K to $6K/flight hour, depending on the aircraft

Personal Aircraft Use: Other differences in Tax v. SEC Rules

- Oddity #1: "Deadheading" is when a plane flies empty to a particular location to pick up an executive;
  - SEC counts deadhead flights; IRS does not
  - For example, plane is located in CA; executive wants plane to come to DC to pick him up and return home
    - IRS taxation: $1700 under SIFL rules (deadhead leg is <u>not</u> included)
    - SEC disclosure: $55,000 = $5K/hour x 11 hours (deadhead leg <u>is</u> included)
- Oddity #2: Family member/guest going along with executive on business trip
  - For example, executive flies from CA to FL on business and back, with spouse
    - IRS taxation: $3400 imputed to the executive (spouse's two flights – out and back)
    - SEC disclosure: $60 (additional catering costs for spouse on each flight)

Combined Business and Personal Aircraft Usage

- This is where most of the questions come
- <u>General rule</u>: Tax and proxy-reporting apply to the <u>portion</u> of the trip that is personal
  - Example: SFO to NY, then detour through SLC on return for personal layover
    - Business portion: SFO – NY – SFO
    - Personal portion: Total cost MINUS (cost of SFO-NY-SFO)

Personal Aircraft Usage: Traps for the Unwary

- Travel from a secondary residence to a business meeting
  - If starting a business trip from a secondary residence or vacation location, then a portion of the trip is treated as personal for proxy purposes (positioning leg from plane location to vacation home); no imputed income
- Commuting
  - Traveling to or from your principal place of business is always personal
  - Tele-commuting may makes this a more difficult analysis for some executives (i.e., is the principal place of business his/her home?), but not usually for the top 5 executives
- "Dropping off" a guest in another location
  - Example: NY to SFO via LAX
  - Increases SIFL and incremental cost charged to the executive for self and all guests (even if you're only dropping off one of several guests)
- Overnight stays: If crew and aircraft return to HQ, additional deadhead and positioning legs are charged to the executive
  - For example, executive in DC taking vacation in SLC for five days; plane drops off family, then returns to HQ, flies back to SLC and returns again (4 flights in total for proxy purposes; 2 flights for tax purposes)

Time-Sharing Agreements – or "how to Avoid the Proxy Disclosure while Still Using Corporate Aircraft"

- Personal travel disclosures in corporate proxies are highly scrutinized – and executives are always looking for ways to avoid that disclosure
  - It's like "TMZ" or "US Weekly" for the corporate crowd
- FAA rules generally prohibit employees or others from reimbursing a company for flights, unless they have a special kind of public-carrier license (which most corporations don't)
  - Therefore, executives cannot simply reimburse the company to avoid the proxy disclosure
- "Time-sharing" agreements are a way around this – and a trend among an increasing number of corporate executives recently
  - Time-sharing is an agreement under which the executive leases the aircraft from the company for certain flights, and agrees to pay the costs and expenses listed in FAA regulations (FAR 91.501(d)) – which includes 2x fuel costs
  - Sample GE time-sharing agreement for here: http://www.sec.gov/Archives/edgar/data/40545/000119312511047479/dex10z.htm
  - It's much more expensive than imputed taxation using SIFL rates, but it lets the executive use the corporate jets for personal travel without the embarrassing proxy disclosure

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