

## Senate Reconciliation Bill Includes Two Harmful Provisions for Business Aircraft

### ISSUE:

The Tax Relief Act of 2005 was approved by the Senate on Friday, November 18, 2005. The bill, as passed by the Senate, contains two provisions of concern to Business Aviation: (1) an expansion of the limitation of employer deductions for certain entertainment expenses; and (2) increased income inclusion to employees for certain use of noncommercial aircraft.

### BACKGROUND:

Congress is currently working to pass a comprehensive budget reconciliation measure. In December, we expect that a House-Senate conference will meet to reconcile the differences between the two bills. As noted, the Senate bill (S. 2020) includes two provisions which are harmful to business aviation.

The first provision would expand the limitations on the deductibility of the "entertainment use" of the business aircraft to ALL employees (currently only board members and senior officers are covered).

This provision expands on a previous deduction limitation created in the 2004 American Jobs Creation Act. The 2004 Act limited the deductibility of entertainment flights by specified individuals (defined to include any person who is the direct or indirect beneficial owner of more than 10 percent of any class of equity security of the company and any officer or director of such company). In June 2005, IRS Notice 2005-45 (June 13, 2005) provided interim guidance on the deductible amount of trade or business expenses for use of a business aircraft for entertainment. NBAA believes that the IRS Guidance goes well beyond the statutory changes made by the Jobs Act, and effectively changes methods of accounting without any Congressional direction.—

- *In defining the expenses that are subject to disallowance, the IRS took the extreme position that a pro rata share of all costs associated with a business aircraft are subject to limitation, failing to distinguish between the incremental costs incurred in connection with actual flights (e.g., overtime for crew members and fuel costs,) and the fixed costs of owning the aircraft that are incurred regardless of whether the flight occurs (e.g., salaries for the pilots, insurance and depreciation).*
- *Also, the IRS requires taxpayers to allocate their airplane expenses to entertainment use based on a new methodology that looks at "occupied seat hours or occupied seat miles," an administrative decision that has no specific statutory authority. The whole concept of correlating employee compensation with the amount of the taxpayer's deduction would be potentially distorted with this "occupied seat" concept.*

NBAA has been working closely with members of the Senate and House to address this issue. Earlier this year, the Senate proposed the expansion to all employees as part of the "Highway bill." The provision was subsequently dropped from the bill.

The provision has now been added to the S. 2020. During Finance Committee consideration of the bill, Senator Jim Bunning (R-KY) filed an amendment to strike the expansion and replace it with report language clarifying the Congressional intent that the IRS Notice 2005-45 on deduction limitations should be changed to provide a primary purpose of flight test and limit the deduction limitations for entertainment use to variable costs only. The amendment was filed and not offered. The issue will now be considered when the bill reaches a House-Senate conference committee.

The second provision of the Tax Relief Act of 2005 would effectively abolish the current fringe benefit valuation for personal use and employees would be taxed at the higher of: (a) fair market value, or (b) full costs (fixed and variable) of the flight. This affects the income inclusion for the employee that travels onboard a company aircraft for non-business reasons.

**SECTION 1. VALUATION OF EMPLOYEE PERSONAL USE OF NONCOMMERCIAL AIRCRAFT.**

(a) **IN GENERAL.**—For purposes of Federal income tax inclusion, the value of any employee personal use of noncommercial aircraft shall equal the excess (if any) of—

(1) greater of—

(A) the fair market value of such use, or

(B) the actual cost of such use (including all fixed and variable costs),  
over

(2) any amount paid by or on behalf of such employee for such use.

(b) **EFFECTIVE DATE.**—Subsection (a) shall apply to use after the date of the enactment of this Act.

**ACTION REQUIRED:**

NBAA is urging the House and Senate to: 1) strike the two provisions noted above from S. 2020, The Tax Relief Act, and 2) insert as report language text that would curb the IRS Notice 2005-45 on deduction limitations to provide a primary purpose of flight test and limit the deduction limitations for entertainment use to variable costs only.

It is critical that NBAA members contact their congressional representatives immediately. Your assistance is required in order to garner support in striking these provisions from the Tax Relief Act of 2005.

Visit the Contact Congress section of the NBAA website (LINK TO: <http://web.nbaa.org/public/govt/action/>) to contact your Members of Congress on this important issue.