

IRS Soars to New Heights on Audits of the Company Jet

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Historically, the Internal Revenue Service (IRS) has fiercely pursued companies for misapplication of the Internal Revenue Code (Code) to purported personal use of the company's owned or chartered aircraft by employees and directors. The Commissioner recently announced that "with expanded resources, IRS work in this area will take off. These aircraft audits will help ensure high-income groups aren't flying under the radar with their tax responsibilities." The IRS will be following the Securities and Exchange Commission's (SEC) similar focus on use of company aircraft that is not "integrally and directly" related to the performance of an executive's duties. The IRS audits will be focused on (i) aircraft usage by large corporations, large partnerships, and high-income taxpayers, and (ii) whether, for tax purposes, an executive's use of jets that are fractionally or 100% company-owned is being properly allocated between business and personal use.

IRS aircraft audits typically cover:

1. The tax deductions taken by the company for the aircraft (including deductions for aircraft use such as the cost of fuel and depreciation deductions for aircraft ownership or charter expenses);
2. The calculations with respect to determining the taxable income attributable to executives, other service providers and their guests for personal use of corporate aircraft under the standard industry fare level (SIFL) rules; and
3. Whether the Code Section 4261 excise tax has been properly assessed in situations where there has been reimbursement for personal use.

The tax implications with respect to aircraft use are quite complex and require in-depth technical knowledge, particularly since 2005, when Congress enacted the Code Section 274 "entertainment disallowance." The entertainment disallowance denies millions of dollars in deductions for a single company-owned aircraft where an executive's personal use is considered to be entertainment (such as vacations). The entertainment disallowance is particularly problematic because, even where the full value of the flight is included in an executive's Form W-2 taxable income, the difference between (a) the aircraft expense to the employer relating to the executive and (b) the amount that is required to be attributed to an executive as income remains non-deductible by the company, unlike other forms of compensation. Later, in the 2017 Tax Cuts and Jobs Act, Congress expanded the flight-cost deductions disallowed to include business entertainment and commuting.

IRS audits to date have included three sets of information document requests (IDRs) requesting information separately to determine (i) the validity of the expenses taken as a deduction, (ii) the Code Section 274 entertainment disallowance, and (iii) the proper service-provider income inclusion. The Code Section 274 entertainment-disallowance IDRs have requested:

1. Flight Log (should include)
 - Flight Date
 - Origin City
 - Destination City
 - Flight Time (Hobbs Meter Reading)
 - Number of Passengers
 - Pilot in Command (PIC)
 - Co-Pilot (SIC)
2. Copy of Flight Log in Electronic Format (Excel, etc.)
3. Aircraft Maintenance Flight Log
4. Passenger Manifest
5. Relationship of Passengers to 5% Owners and “Specified Individuals”
6. Tail Number of the Aircraft; Aircraft Registration Number; Manufacturer’s Serial Number; Type and Model of the Aircraft; and Number of Passenger Seats on the Aircraft
7. Aircraft Purchase Documents
8. Aircraft Lease/Charter Documents
9. Aircraft Management Contracts
10. Minutes/Documents indicating the Business Purpose of the Aircraft
11. Company Policy on the Aircraft Usage

The IRS states it will be using advanced analytics and resources from the Inflation Reduction Act to more closely examine this area. The number of audits related to aircraft usage could increase in the future following initial results, and as the IRS continues hiring additional examiners.

Winston & Strawn has the extensive experience to assist in these highly complex and technical aircraft audits. Please contact your relationship attorney or Ruth Wimer for more information.

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