Technical Advice Memorandum 9608004

November 3, 1995

ISSUE

Does §274(a)(1) of the Internal Revenue Code disallow deductions to the taxpayer for expenditures related to the use of an aircraft and, if so, to what extent?

FACTS

The taxpayer, X, owns a fixed-wing aircraft that was used for the furtherance of its trade or business during the years involved. Eighty percent of the aircraft's total flight hours was attributable to valid business purposes directly related to the active conduct of X's trade or business. The remaining 20 percent was attributable to the transportation of customer representatives on hunting trips sponsored by X.

X incurred expenditures related to the use of the aircraft for such items as fuel and oil, insurance, pilot's salary, repairs, hangar rental, and depreciation. X claimed deductions for 100 percent of these items. The examiner disallowed 20 percent of the deductions claimed, categorizing that amount as nondeductible entertainment expenditures.

APPLICABLE LAW

Under §162 a taxpayer may deduct the ordinary and necessary expenses of carrying on a trade or business, and §167 allows a deduction for depreciation of property used in a trade or business. However, under §161 these deductions are subject to the limitations imposed by §274.

Section 274(a)(1)(B) disallows deductions for any item with respect to a facility used in connection with an activity referred to in §274(a)(1)(A). Section 274(a)(1)(A) refers to an activity generally considered to constitute entertainment, recreation, or amusement.

Section 1.274-2(e)(2)(i) of the Income Tax Regulations defines a facility used in connection with entertainment as, generally, any item of personal or real property (including airplanes) owned, rented, or used by the taxpayer for, or in connection with, entertainment. Under §1.274-2(b)(1)(i) the term "entertainment" refers to any activity of a type generally considered to constitute entertainment, amusement, or recreation, including hunting trips. Section 1.274-2(e)(3)(i) provides that expenditures with respect to a facility used in connection with entertainment include depreciation and operating costs.

Prior to 1979, substantiated ordinary and necessary expenses with respect to entertainment facilities were deductible if (1) the facility was used primarily for the furtherance of the taxpayer's trade or business, and (2) the expenses were directly related to the active conduct of the trade or business.

Section 361(a) of the Revenue Act of 1978, 1978-3 C.B. (Vol. 1) 1, 81, amended §274(a)(1)(B) by generally disallowing deductions for entertainment facilities, regardless of primary use or whether directly related to the active conduct of the trade or business. Congress intended to eliminate deductions related to most entertainment facilities. S. Rep. No. 1263, 95th Cong., 2d Sess. (1978), 1978-3 C.B. (Vol. 1) 315, 472. However, the legislative history clearly indicates that Congress did not mean to make all facility expenses nondeductible; expenses related to transportation facilities used for business trips would continue to be deductible:

Similarly, expenses incurred with respect to certain transportation facilities, for example, automobiles and airplanes, would be allowed provided that the taxpayer establishes that the facility was used primarily for the furtherance of a trade or business, and that the expenses otherwise met the ordinarily applicable rules with respect to business deductions.

Id. at 473-474.

Section 1.274-2(b)(1)(iii) provides special definitional rules for expenditures that might be considered paid or incurred either for travel or for entertainment. Generally, such expenditures are considered to be expenditures for entertainment under §1.274-2(b)(1)(iii)(a). However, §1.274-2(b)(1)(iii)(c) provides this exception:

(c) Expenditures deemed travel. An expenditure described in (a) of this subdivision shall be deemed to be for travel to which this section does not apply if it is:

(1) With respect to a transportation type facility (such as an automobile or an airplane), even though used on other occasions in connection with an activity of a type generally considered to constitute entertainment, to the extent the facility is used in pursuit of a trade or business for purposes of transportation not in connection with entertainment.

RATIONALE

Because the aircraft was personal property owned by X and used in connection with hunting trips, under §274(a)(1)(B) it was a facility used in connection with an entertainment activity. Although §274(a)(1)(B) clearly establishes that expenditures related to such a facility are generally nondeductible, the regulations provide a specific "carve out" for expenditures incurred in connection with the nonentertainment use of an aircraft for transportation in a trade or business. Under §1.274-2(b)(1)(iii)(c), such expenditures constitute deductible travel expenditures. The remaining expenditures, however, are entertainment expenditures disallowed under §274(a)(1)(B).

X contends that §1.274-2(b)(1)(iii)(c) allows a deduction for all expenses related to a aircraft that receives any use in the trade or business. It is clear, however, that this provision provides only a limited exception to the disallowance of entertainment expenditures under §274(a)(1)(B). X's interpretation is clearly inconsistent with the underlying legislative history and the regulations. Expenditures related to an aircraft used for mixed purposes, that is, entertainment and business,

are considered travel expenses to the extent, not if, the aircraft is used for transportation purposes in a trade or business not related to entertainment.

CONCLUSION

Eighty percent of the expenditures related to the use of the aircraft are business travel expenditures deductible to the extent allowed by §§162 and 167, and they are not disallowed by §274(a)(1)(B). The remaining twenty percent of the expenditures are expenditures with respect to a facility used in connection with an activity of a type generally considered to constitute entertainment, and they are disallowed under §274(a)(1)(B).

A copy of this technical advice memorandum is to be given to X. Section 6110(j)(3) provides that it may not be used or cited as precedent.