August 24, 2020

Via Regulations.gov
CC:PA:LPD:PR (REG-119307-19)
Internal Revenue Service
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: IRS REG-119307-19
Comments on Prop. Treas. Reg. § 1.274-14

Dear Sir or Madam:

The National Business Aviation Association (NBAA) represents more than 11,000 member companies that depend on general aviation aircraft to make their businesses more productive and successful. The United States business and general aviation industry, which includes all operations other than scheduled airline flights and the military, supports 1.2 million jobs and $247 billion in economic impact.

We appreciate the opportunity to submit these comments on behalf of the business aviation community with respect to Prop. Treas. Reg. § 1.274-14, which was issued in the federal register with a Preamble on June 23, 2020. "Qualified Transportation Fringe, Transportation and Commuting Expenses under Section 274," 85 Fed. Reg. 37,599 (Jun. 23, 2020).
We request that a public hearing be scheduled, and we would like to provide comments at such hearing.

Prop. Treas. Reg. § 1.274-14 relates to the disallowance in § 274(*l*) of commuting expenses, which was enacted in the Tax Cuts and Jobs Act (TCJA) (P.L. 115-97). On June 13, 2018, NBAA submitted a request to the IRS for priority guidance on certain issues arising under § 274(*l*) ("2018 Comments"). A copy of that prior request for guidance is attached hereto as Exhibit A.

1. **Compensation Fringe Benefits Reported as Taxable Compensation to the Employee**

Prior to the TCJA, employers deducted the costs of providing transportation fringe benefits to employees, even though employees were entitled to exclude qualified transportation fringe (QTF) benefits from their taxable income. Under I.R.C. § 132(f), QTFs are mostly commuting costs. Thus, there was an inconsistency in that employers deducted the costs of QTFs, but employees also excluded them from taxable income. The TCJA addressed this inconsistency through § 274(a)(4) which disallows deductions for QTFs and § 274(*l*) which disallows the deduction for providing commuting benefits to employees. Accordingly, the TCJA amendments cured the inconsistency by disallowing the employer's deduction of the costs attributable to excluded transportation fringe benefits.

However, Prop. Treas. Reg. § 1.274-14 does not address the question of whether the disallowance of commuting expenses under § 274(*l*) applies to the cost of commuting benefits when the employer properly reports the value of such commuting benefits as a taxable fringe benefit to the employee (such as by including it in the employee's Form W-2).

The Preamble to the proposed regulations notes that the compensation exception in § 274(e)(2) cannot apply to the commuting disallowance in § 274(*l*). 85 Fed. Reg. 37,608. Of course, the exceptions in § 274(e) apply under the statutory language of § 274(e) only to the specific disallowance provisions in § 274(a) (which do not include § 274(*l*)). *See* § 274(e) ("Subsection (a) shall not apply to . . ."). This observation from the Preamble, which tracks the statutory language of § 274(e), does not resolve the question of whether § 274(*l*) will be interpreted to mean that an employer's costs of providing commuting will be disallowed even when the employer reports the value of the commuting benefit as taxable income to the employee.

Disallowing the deduction of employer commuting expenses under § 274(*l*), while taxing the value of the commuting received by the employee, would result in double taxation. In other contexts, regulations have avoided double taxation by providing that nondeductible items included in taxable compensation to employees are deductible as compensation expense by the employer. For example, as we noted in our 2018 Comments, the disallowance of deductions for spouse travel under § 274(m)(3) is complemented by Treas. Reg. § 1.274-2(f)(2)(iii) which provides that such costs are deductible by the employer if they are reported as taxable income to the employee. In this regard, the entertainment disallowance in § 274(a) applies to "deduction[s] otherwise allowable under this chapter," while the deduction disallowances in §§ 274(*l*) and (m) contain no similar provision. More generally, costs incurred by an employer for fringe benefit items which may be nonbusiness items (such as personal, family and living expenses under § 262) are typically deducted by the employer as compensation expense and their value is taxed to the employee. *See* Treas. Reg. § 1.162-25T. In this manner, the employer's compensation deductions and the employee's income are consistent and double taxation is generally avoided.

Under the policy of avoiding double taxation, NBAA requests that regulations provide that if the value of the commuting benefit is reported by the employer as compensation to the employee, then the employer should be permitted to deduct the cost of the commuting benefit as compensation expense in accordance with Treas. Reg. § 1.162-25T. Adopting such a regulation is consistent with the regulatory approach taken with respect to the spouse travel disallowance in § 274(m)(3) and the fringe benefit rules generally which are structured to avoid double taxation.

The courts have held that interpretations of tax laws that result in double taxation are to be avoided. In *In re Tax Refund Litigation*, 766 F. Supp. 1248 (E.D.N.Y. 1991), *aff'd*, 989 F.2d 1290 (2d Cir. 1993), the court explained as follows:

> Even if a double tax is imposed, however, it will not be per se impermissible. *United States v. Hemme*, 476 U.S. 558, 572, 106 S.Ct. 2017, 2079, 90 L.Ed.2d 538 (1986); *Hellmich v. Hellmich*, 276 U.S. 233, 238, 48 S.Ct. 244, 246, 72 L.Ed. 544 (1928). Thus the second stage of the analysis requires an examination of the statute and the legislative history to determine whether such Congressional intent can be divined. In the course of this analysis, it must be remembered that double taxation is disfavored . . . .

See also, Federated Mutual Implement & Hardware Ins. Co. v. Comm'r, 266 F.2d 661 (8th Cir. 1959) (explaining that the foreign tax credit was intended to "mitigate the evil of double taxation").

As stated above, in order to interpret a tax statute as imposing double taxation, the statute and legislative history must be examined to determine whether Congress intended to impose double taxation. In the case of § 274(*l*), the purpose of the statute was to address an inconsistency in the taxation of fringe benefits, not to create a new inconsistency by requiring the disallowance of commuting expenses when such expenses are reported as income to the employee. Imposing double taxation is a harsh treatment that should only be imposed on an activity that Congress seeks to discourage. Nothing in the legislative history suggests that Congress views commuting to and from work as an activity that should be discouraged or penalized by double taxation. In fact, the QTF rules were intended to promote employer-provided commuting benefits. Accordingly, to avoid a double tax treatment of commuting benefits, we request that regulations be adopted similar to the regulations pursuant to the spouse travel rules to allow the employer to deduct the cost of commuting benefits if the employer reports the value of the flight to the employee in the manner required under Treas. Reg. § 1.162-25T.

As the Preamble points out, the compensation exception in § 274(e)(2) applies by its terms only to disallowance provisions in § 274(a), which do not include § 274(*l*). Therefore, regulations to avoid double taxation with respect to § 274(*l*) would not include the detailed provisions of § 274(e)(2), such as the special rule for specified individuals or the limitation on the deduction to the amount imputed to the employee.

2. Deductible Business Travel Distinguished from Commuting

Prop. Treas. Reg. § 1.274-14(a) explains that the term "travel between the employee's residence and place of employment" in § 274(*l*) "includes travel that originates at a transportation hub near the employee's residence or place of employment."

This hub concept is unnecessary, and it is likely to produce unintended results. It would seem reasonable for regulations to explain that travel from a residence to a place of employment is subject to § 274(*l*), when the travel originates at the residence and ends at the place of employment irrespective of the use of different modes of transportation on the trip. For example, the trip could originate at the residence with a taxi ride to the airport followed by a flight to another airport, and end with a taxi ride from the second airport to the place of employment.

In contrast, using the hub concept to address the use of different modes of transportation on a single trip may have the unintended consequence of disallowing purely business travel between two places of employment. Suppose the executive has a principal residence and principal place of employment in City A and his employer also has an office in City B. If the executive flies from an airport in City A to an airport in City B in connection with his employment, the flight from a hub in City A could be viewed as nondeductible flight under § 274(*l*) from a residence to a place of employment. There is no reason to expect that this provision was intended to apply to business travel between places of employment. Accordingly, the hub concept should be discarded in favor of an explanation that the application of § 274(*l*) to travel between a residence

and place of employment is not affected by the use of different modes of transportation on the trip.

More generally, the proposed regulations should clarify that § 274(*l*) applies only to travel that constitutes "commuting" for tax purposes. The disallowance in § 274(*l*) of deductions for transportation between an employee's residence and place of employment codifies the concept that commuting between the employee's home and place of employment does not constitute business travel for tax purposes. This provision complements the disallowance of deductions for qualified transportation fringe benefits in § 274(a)(4) as part of the TCJA's effort to address certain inconsistences in the tax code.

There is no indication that Congress intended to apply this disallowance to business travel from an employee's residence to a secondary place of employment, which is not commuting. This potential effect of § 274(*l*) should be addressed through regulations to prevent the unintended consequence of disallowing deductible business travel. It seems obvious that such business travel expenses should remain working condition fringe benefits excluded from employees' income under § 132(d).

Failure to remedy this unanticipated consequence of § 274(*l*) could result in the following unintended negative consequence. It is not unusual for an employee to live and work primarily in one city (City A), and to work for an employer with offices in many other cities (including City B) at which the employee may work from time to time. In this situation, the employee's travel from his residence in City A to his employer's office in City B could be nondeductible under § 274(*l*), even though such travel would otherwise qualify as business travel and not be commuting. *See Markey v. Comm'r*, 490 F.2d 1249 (6th Cir. 1974). Such an unintended application of § 274(*l*) could unexpectedly disallow business travel deductions for many companies which are already struggling due to the COVID-19 pandemic and result in unnecessary tax audits and costly litigation.

Accordingly, we request that the regulations clarify that the disallowance in § 274(*l*) applies only to travel classified as "commuting" and not to otherwise deductible business travel.

3. Only Marginal Costs of Providing Commuting Benefits Should Be Disallowed

Prop. Treas. Reg. § 1.274-14 does not provide guidance on how to determine expenses "in connection with" commuting benefits for purposes of the disallowance under § 274(*l*). As we explained in our 2018 Comments, the commuting disallowance in § 274(*l*) is worded almost exactly the same as the spouse travel disallowance in § 274(m)(3). The spouse travel disallowance applies only to the marginal costs of spouse travel, as the IRS has made clear for many years in IRS Pub. 463, at 5. The same cost allocation principles should apply under § 274(*l*).

Furthermore, applying a marginal cost disallowance to commuting costs under § 274(*l*) is consistent with the cost allocation rules generally. Pursuant to the general allocation rules under § 162, the presence of a nonbusiness passenger on a flight on a business aircraft results only in the marginal cost of that nonbusiness passenger's travel being a nondeductible personal expense. Treas. Reg. § 1.162-2(b). In this regard, Rev. Rul. 56-168, 1956-1 C.B. 93, explained that only

expenses "because of the wife's presence" on a trip are non-deductible, meaning that only the marginal cost of the spouse traveling on the business trip should be disallowed. *See also French v. Comm'r,* T.C. Memo. 1990-34; *Pohl v. Comm'r,* T.C. Memo. 1990-298; *Marlin v. Comm'r,* 54 T.C. 560 (1970), *acq*. 1970-2 C.B. xx.

The general allocation rules for distinguishing personal from business expenses are modified by the listed property rules, which require that costs to operate listed property such as a business aircraft must be allocated based on hours unless a different method is prescribed by the Commissioner. Treas. Reg. § 1.274-5T(b)(6)(i)(B). No different allocation method has been prescribed under the listed property rules. However, under the entertainment disallowance rules, the allocation of costs to a flight on an employer-provided aircraft is further subdivided proportionately among the passengers. Treas. Reg. § 1.274-10(e). (Thus, the listed property allocation rules and the entertainment disallowance rules for employer-provided aircraft are inconsistent.)

Since the deduction disallowance rules for spouse travel under § 274(m)(3) and for commuting under § 274(*l*) are not governed by the listed property allocation rules or the entertainment disallowance rules, it follows that they should apply the general allocation rule that disallows only the marginal costs. As noted above, IRS Pub. 463, at 5, confirms that the marginal cost allocation principle applies to the spouse travel rules under § 274(m)(3), and the same principle should apply to the commuting disallowance under § 274(*l*).

Accordingly, the regulations should explain that the disallowance of commuting expenses applies to the marginal costs of providing the commuting benefit.

4. Exception for Travel To Ensure the Safety of the Employee

Prop. Treas. Reg. § 1.274-14(b) states if there is a bona fide business-oriented security concern as described in Treas. Reg. § 1.132-5(m) for the employee, then the commuting benefit will be deemed necessary for the safety of the employee for purposes of § 274(*l*). This provision is helpful to clarify when the safety of the employee exception applies.

To further clarify this exception, we suggest the following examples:

a. In an example, an overall security program and security study meeting the requirements of Treas. Reg. § 1.132-5(m)(2)(iv) are implemented for an employee. The study finds that the employee is subject to a bona fide business-oriented security concern due to the risks of being kidnapped or robbed while traveling. In this situation, the safety of the employee exception applies.

b. In another example, an employee is at risk when traveling due to the risks of being kidnapped or robbed. The employer and employee believe in good faith that the commuting benefits are necessary to ensure the safety of the employee. No overall security program is implemented for the employee within the meaning of Treas. Reg. § 1.132-5(m)(2)(ii). In this situation, the safety of the employee exception applies.

c. In another example, an individual has medical conditions that put him at high risk of contracting or dying from COVID-19. His employer provides private air travel to him to reduce this risk. During the pandemic, the safety of the employee exception applies.

5. Section 274(*l*) Applies Only to Employees

Section 274(*l*) applies to commuting benefits provided only to "employees." The regulations should clarify the scope of the term "employee" for purposes of § 274(*l*). Specifically, the regulations should confirm that the term "employee" does not include sole proprietors, independent contractors, partners, and 2% shareholders of S corporations.

As noted in our 2018 Comments, Chief Coun. Adv. 2003-44-008 (Jul. 1, 2003) explains that for purposes of the compensation exception in § 274(e)(2) and (9) the treatment of partners and 2% S corporation shareholders as nonemployees for income tax benefit purposes arises from I.R.C. § 1372 and Treas. Reg. § 1.707-1(c). Guidance stating that the same definition of employee applies for purposes of the QTF regulation is provided at Prop. Treas. Reg. § 1.274-13(b)(2). The same definition of employee should likewise be provided for purposes of Prop. Treas. Reg. § 1.274-14.

* * *

Please contact me at sobrien@nbaa.org or 202-783-9451 with further questions. Thank you for your consideration of these comments.

Sincerely,

Scott O'Brien
Senior Director, Government Affairs

Enclosures: 1

Exhibit A

June 13, 2018

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2018-43)
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Recommendations for 2018-2019 Priority Guidance Plan (Notice 2018-43)

Dear Sir/Madam:

This letter is submitted by the National Business Aviation Association ("NBAA") in response to the invitation published in Notice 2018-43 for recommendation of items for inclusion on the 2018-2019 Priority Guidance Plan.

NBAA represents more than 11,000-member companies and is the leading organization for companies that own or operate general aviation aircraft to make their businesses more efficient, productive and successful.

With passage of the Tax Cuts and Jobs Act, NBAA members are seeking guidance on certain aspects of the following provisions in P.L. 115-97:

- Sec. 13201: Temporary 100-Percent Expensing For Certain Business Assets
- Sec. 13304: Limitation On Deduction By Employers Of Expenses For Fringe Benefits
    - Disallowance of Entertainment Expenses
    - Disallowance of Commuting Expenses

The enclosures included with this letter provide details on our specific guidance requests. We believe guidance in these areas will assist with tax administration and answer questions that NBAA members have developed in their review of the Tax Cuts and Jobs Act.

Thank you in advance for your consideration of these requests. If you have questions, please contact me at (202) 783-9451 or sobrien@nbaa.org.

Sincerely,

Scott O'Brien
Senior Director, Government Affairs

cc: The Honorable David J. Kautter, Assistant Secretary (Tax Policy), Department of the Treasury and Acting Commissioner, Internal Revenue Service

Tom West, Tax Legislative Counsel, Department of the Treasury

William M. Paul, Acting Chief Counsel and Deputy Chief Counsel (Technical), Internal Revenue Service

Request for Guidance on Sec. 13201 of PL 115-97
Temporary 100-Percent Expensing For Certain Business Assets

Overview

The Tax Cuts and Jobs Act (TCJA) amended Internal Revenue Code (IRC) § 168(k) to provide for 100-percent bonus depreciation, allowing taxpayers an immediate deduction of the cost of qualifying property acquired and placed in service after Sept. 27, 2017 and before Jan. 1, 2027 (Jan. 1, 2028 for longer production period property and certain aircraft).

NBAA requests guidance on the following issues related to the extension and modification of 100-percent bonus depreciation.

1. Prohibition on Prior Use of Used Property

IRC § 168(k)(2)(A) has always provided that to qualify for bonus depreciation, the original use of the property must begin with the taxpayer. The TCJA expanded this original use requirement to permit bonus depreciation for used property, so long as "such property was not used by the taxpayer at any time prior to such acquisition." *See* § 168(k)(2)(E)(ii).

We believe that if the taxpayer conducts incidental "use" of the property, the property should still meet the acquisition requirements. For example, there are situations where a taxpayer could charter or conduct a demonstration flight on a business aircraft that it later acquires. For these types of flights, the taxpayer is not the operator of the aircraft, so the aircraft should not be viewed as having been "used" by the taxpayer for purposes of the original use requirement.

2. Effective Date of Section 168(k)(8)

The TCJA provides in § 168(k)(8) that property acquired by the taxpayer before September 28, 2017 and placed in service by the taxpayer after September 27, 2017 is subject to 50 percent bonus depreciation, and to a phase down of the bonus depreciation rate for property placed in service in subsequent years. Section 13201(h) of the TCJA provides an effective date rule under which the TCJA bonus depreciation provisions apply to property that is both acquired and placed in service after September 27, 2017. That section further provides that for purposes of this effective date rule, "property shall not be treated as acquired after the date on which a written binding contract is entered into for such acquisition."

This raises the question of when could § 168(k)(8) ever apply? Under the effective date provision described above, property acquired prior to September 28, 2017 would not be subject to the provisions enacted under § 13201 of the TCJA. Since § 168(k)(8) is a provision enacted under § 13201(a)(3)(B) of the TCJA, it could only apply to property acquired after September 27, 2017. Thus, because § 168(k)(8) only applies to property acquired before that date, § 168(k)(8) would apparently never apply. The inconsistent provisions leading to this conclusion do not appear to be intended.

We suggest this inconsistency be clarified by an explanation that § 168(k)(8) applies to property acquired prior to September 28, 2017, and placed in service after that date, notwithstanding the effective date provision in § 13201(h) of the TCJA.

To harmonize the provisions, the effective date provision in § 13201(h) under which the acquisition date is deemed to be no later than the written binding contract date should continue to apply for purposes of § 168(k)(8). Otherwise, property purchased after September 27, 2017, with a written binding contract prior to that date would not be subject to the TCJA provisions or § 168(k)(8) even with the modification suggested above. By default, such property would apparently be governed by prior law.

3. Self-Constructed Property

Generally, self-constructed property is "acquired" when construction begins, which is when significant physical work begins. Presumably, the taxpayer is not the actual manufacturer of the aircraft. Under the self-constructed property regulations, an aircraft is self-constructed by the taxpayer if it is constructed for the taxpayer pursuant to a written binding contract entered into before construction begins.

Suppose a taxpayer enters into a written binding contract for the construction of a new aircraft prior to September 28, 2017, and prior to the beginning of construction on the aircraft. Suppose further that construction actually begins after September 27, 2017.

Arguably, acquisition is deemed to occur when the written binding contract was entered into, prior to September 28, 2017, which would preclude the aircraft from qualifying for 100% bonus depreciation under the TCJA. This rationale treats the written binding contract to construct the aircraft as if it were a contract to buy the aircraft.

In our view, a written binding contract to engage a company to construct an aircraft should not be treated as a contract to purchase the aircraft. Under the view that a contract to construct an aircraft differs from a contract to purchase an aircraft, a self-constructed aircraft would be treated as acquired by the taxpayer when construction begins, rather than when the contract is signed to engage the company to construct it. Thus, if constructions begins after September 28, 2017, the aircraft could qualify for 100% bonus depreciation. We request guidance to clarify that the latter view is correct.

4. Written Binding Contract

To be a written binding contract, Treas. Reg. § 1.168(k)-1(b)(4)(ii)(A) requires that the contract be binding on the buyer, but it does not require that the contract be binding on the seller. This is logical, since the buyer is the taxpayer seeking to claim bonus depreciation on the aircraft. The regulation further provides that if there are liquidated damages, then the contract will not qualify as a written binding contract if such liquidated damages are limited to an amount less than 5%. While the regulation does not actually state that this liquidated damages provision is applicable to only the buyer and not the seller, that is the only logical interpretation. We request guidance be provided to clarify that this interpretation is correct.

Request for Guidance on Sec. 13304 of PL 115-97
Disallowance of Entertainment Expenses

Overview

The TCJA modified § 274 of the IRC such that entertainment expenses directly related to (or associated with) a taxpayer's trade or business are no longer deductible. Prior to passage of the TCJA, entertainment expenses that were directly related to (or associated with) a taxpayer's trade or business were generally deductible under § 274(a), subject to a 50 percent limitation in § 274(n).

Recommendations for Guidance

The TCJA modifications to § 274(a)(1)(A) present new and unexpected issues for companies that utilize business aircraft. NBAA requests the following guidance to interpret these legislative changes.

1. Entertainment Expenses on Trips Primarily for Business

The section-by-section summary of the TCJA provided by the Senate Finance Committee explains that the new limitation under § 274 is designed to "eliminate the subjective determination of whether such (entertainment) expenses are sufficiently business related." While the effect of the amendment is to eliminate deductions for entertainment expenses that are directly related (or associated with) business, many business trips involve a combination of activities, only some of which should be defined as entertainment.

The existing regulations defining entertainment under Treas. Reg. § 1.274-2(b) do not discuss the need to consider multiple activities undertaken on a single trip in the determination of whether the travel costs (*e.g.*, air travel, meals, and lodging) should be subject to the entertainment disallowance. Since the purpose of the TCJA amendment is to eliminate the need to determine whether an entertainment expense is sufficiently business-related, guidance is requested with respect to the treatment of entertainment expenses on trips that are primarily for business.

Such guidance should clarify that in the case of trips with multiple activities (some of which are entertainment), it is necessary to determine whether the trip is primarily for entertainment (and therefore subject to the disallowance), or primarily for a non-entertainment purpose (and therefore not subject to the entertainment disallowance). If the trip is primarily for non-entertainment purposes (such as business), then the entertainment disallowance should only apply to the direct costs of an entertainment activity undertaken on the trip. The deductibility of travel costs for a primarily non-entertainment trip (*e.g.*, air travel, lodging, meals) should be evaluated in accordance with the tax treatment of the non-entertainment purpose (*e.g.*, business).

For example, if an employee travels to a business meeting, and one evening during the trip the employee goes to a movie for entertainment, the company should not be subject to a disallowance for the travel costs related to the trip. Only the cost of the movie ticket should be a non-deductible entertainment expense.

This conclusion is supported by the conference report to the TCJA which states that the change to § 274(a)(1)(A) is intended to disallow "an activity generally considered to be entertainment, amusement or recreation." Since the legislative intent is to disallow the costs of the entertainment activity only, we request that guidance be provided to clarify that when entertainment expenses are incurred on a trip that is primarily for non-entertainment purposes, the entertainment disallowance under § 274(a) should not apply to the travel costs (*e.g.*, flight, meals, and lodging).

2. Primary Purpose Test

In making the above determination of whether the entertainment disallowance applies to only the direct costs of the entertainment activity (*e.g*., the movie ticket), or to the travel costs associated with the trip (*e.g.*, air travel, meals, lodging), guidance should clarify that the determination be made based on the primary purpose of the trip.

The primary purpose standard is already used to make the distinction between business or personal travel under Treas. Reg. § 1.162-2(b). In addition, the existing business entertainment regulations under Treas. Reg. § 1.274-2(c)(3)(iii) focus on the "principal character" of the trip. Thus, the primary purpose test is consistent with the test applicable for purposes of the ordinary and necessary business test under § 162, and the test used by the regulations to determine whether an entertainment activity is directly related to business.

In addition, Congress has stated that a primary purpose test should exist for purposes of determining if a trip is subject to a deduction disallowance. In the Joint Committee on Taxation Report accompanying the Revenue Act of 1978, the primary purpose test was set forth with respect to transportation facilities as follows:

> Similarly, expenses incurred with respect to certain transportation facilities, for example automobiles and airplanes are allowable to the extent allocable to travel undertaken primarily for the furtherance of a trade or business even if the taxpayer engages in some entertainment activities during the business trip.

Staff of the J. Comm. on Tax'n, 95th Cong., *General Explanation of the Revenue Act of 1978*, at 207-8 (J. Comm. Print 1978).

Treas. Reg. § 1.162-2(b) explains that the primary purpose determination should be based on reviewing the "facts and circumstances in each case." The regulations further explain that time spent on business or non-business activities is one of the factors in making this determination. Similarly, the principal character test provides that the relative amounts of time spent on entertainment and non-entertainment activities during the trip is not the only factor in determining the primary purpose. *See* Treas. Reg. § 1.274-2(c)(3)(iii).

We request guidance that confirms a primary purpose test applies for purposes of determining whether flight expenses are disallowed following the TCJA changes to § 274.

3. Reconsideration of Situations Previously Viewed as Business Entertainment

The business entertainment regulations under Treas. Reg. § 1.274-2(c), (d) present rules and examples addressing situations in which the exceptions for entertainment activities directly related to (or associated with) business apply. For example, the business entertainment regulation at Treas. Reg. § 1.274-2(c)(4) with respect to a clear business setting explains:

> Generally, entertainment shall not be considered to have occurred in a clear business setting unless the taxpayer clearly establishes that any recipient of the entertainment would have reasonably known that the taxpayer had no significant motive, in incurring the expenditure, other than directly furthering his trade or business.

The regulation then provides the example of a "hospitality room" at a trade show or convention, which it states would be directly related to business.

With the TCJA repeal of the business entertainment exceptions, it becomes necessary to examine whether certain events, which are discussed in the business entertainment regulations as examples of activities directly related to (or associated with) business, are actually "entertainment" in the first place.

Under § 274(a)(1)(A), "entertainment" is defined as "an activity which is of a type generally considered to constitute entertainment, amusement, or recreation." The clear business setting regulation described above recognizes the well-understood fact, that in most cases, attendees at a business trade show are not there for entertainment, amusement or recreation. While the clear business setting rule is presented in the context of the business entertainment exception, the common-sense reasoning underlying the analysis equally supports the conclusion that the hospitality room does not constitute an entertainment activity in the first place.

The necessity of reconsidering whether activities that can apparently qualify for the business entertainment exception are truly entertainment in the first place is broader than just activities occurring in a clear business setting.

Therefore, we request that guidance issued with respect to the TCJA changes to § 274(a)(1)(A), acknowledge that activities which had qualified for the business entertainment exception should not automatically be considered as constituting entertainment. In determining if an activity is actually entertainment, the relevant facts and circumstances should be considered.

1. Qualified Business Use Under Section 280F(b)

Under § 280F(b) there are special rules for an aircraft to qualify for accelerated depreciation. That section, and the regulations thereunder, provide that use of an aircraft in a trade or business of the taxpayer constitutes "qualified business use" for purposes of § 280F(b). *See* § 280F(d)(6)(B); Treas. Reg. § 1.280F-6(d)(2). Since § § 280F(b) and 274(a) do not cross reference each other, we believe it is clear that modifications to § 274(a) under the TCJA have no effect on the determination of "qualified business use" for purposes of § 280F, but we would appreciate clarification of that point.

Request for Guidance on Sec. 13304 of PL 115-97
Disallowance of Commuting Expenses

Overview

Business aircraft are sometimes used to transport employees between an employee's residence and place of employment. Under pre-2018 law, expenses attributable to these flights were deductible to the employer as compensation fringe benefits qualifying as ordinary and necessary business expenses under § 162 of the IRC.

New § 274(*l*) enacted under the TCJA provides that an employer may not deduct expenses incurred in providing transportation between an employee's residence and place of business, referred to herein as "commuting." This new subsection appears intended to be consistent with other provisions that deny deductions to employers for commuting benefits provided to employees on a tax-free basis. However, there is an exception in § 274(*l*)(1) that allows for deductions of commuting costs necessary for "ensuring the safety of the employee."

Recommendations for Guidance

NBAA requests guidance in the following areas to interpret this new subsection.

1. **Compensation Fringe Benefits Reported as Taxable Compensation to the Employee**

While new § 274(*l*) appears to backstop other provisions that deny deductions to employers for commuting benefits provided to employees on a tax-free basis, there is no reason to infer that it was intended to limit employer deductions for commuting benefits provided to an employee and properly reported as income to the employee. It is not uncommon for regulatory guidance to remedy unintended double-counting situations, such as by limiting the employer disallowance of an expense for an item which is treated as taxable compensation to an employee.

For example, in Treas. Reg. § 1.274-2(f)(2)(iii), the IRS issued guidance preventing such double-counting by limiting the disallowance of an employer's deduction for spousal travel under § 274(m)(3). At a minimum, the amount imputed to the employee for the commuting flight should be deductible by the employer. However, we believe that in the absence of specific "to the extent that" language limiting the deduction, as is found in § 274(e)(2)(B), the full amount of the expenses of a commuting flight should be deductible if the employer imputes the proper amount to the employee. Under Treas. Reg. § 1.274-2(f)(2)(iii), expenses subject to § 274(m)(3) are completely exempt from disallowance if the proper amount is imputed to the employee, and the same rule should apply to expenses described in § 274(*l*) in view of the nearly identical disallowance language in these two subsections.

2. **Deductible Business Travel Distinguished from Commuting**

Guidance should be issued to identify commuting flights subject to disallowance pursuant to the § 274(*l*)(1) reference to "travel between the employee's residence and place of employment."

It seems clear that § 274(*l*) should not apply to flights for business travel which would be deductible as ordinary and necessary business travel expenses under § 162 and would thus not be included in the employee's income. For example, when an employee travels from the employee's residence to the

employee's secondary place of employment in a different city than the employee's primary place of employment, the flights would be deductible as an ordinary and necessary business expense. *See* Rev. Rul. 99-7, 1999-1 C.B. 361 (daily transportation); Rev. Rul. 93-86, 1993-2 C.B. 71 (overnight travel); *Markey v. Comm'r*, 490 F.2d 1249 (6th Cir. 1974).

As a result, regulatory guidance under § 274(*l*) should make clear that the commuting disallowance does not apply to flights that are otherwise properly classified as deductible business travel.

3. **Only Marginal Costs of Providing Commuting Benefits Should Be Disallowed**

If an employee's flight is determined to be a commuting benefit provided by the employer, only the marginal cost of providing the commuting benefit should be potentially subject to the disallowance. This approach is supported by § 274(m)(3), which uses almost identical disallowance language, and only disallows the marginal costs of travel expenses with respect to a spouse, child or other non-employee on a business trip.

The disallowance of only marginal costs under § 274(m)(3) is explained very clearly in IRS Pub. 463, at 5 (2017), which discusses the rule under § 274(m)(3), and provides the example of a man traveling by car to Chicago for business with his wife who is not traveling for business. The example concludes that the disallowance under § 274(m)(3) applies, but since there are not marginal costs associated with his wife's presence, the man "can deduct the total cost of driving his car to and from Chicago."

Likewise, in Rev. Rul 56-168, 1956-1 C.B. 93, the IRS further explained that only expenses "because of the wife's presence" on a trip are non-deductible, meaning that only the marginal cost of a spouse traveling on the business trip should be disallowed. *See French v. Comm'r*, T.C. Memo. 1990-34; *Pohl v. Comm'r*, T.C. Memo. 1990-298; *Marlin v. Comm'r*, 54 T.C. 560 (1970), *acq*. 1970-2 C.B. xx.

Since the disallowance of expenses provided in new § 274(*l*) uses language almost identical to the language in § 274(m)(3), and neither of those sections includes a cross-reference to the entertainment disallowance rules under § § 274(a) or (e), the marginal cost disallowance approach of § 274(m)(3) should apply to any disallowance of commuting benefits under § 274(*l*). As business flights often include travelers with different destinations and purposes, looking at the specific marginal costs to the employer of providing the commuting benefit will provide the most accurate and equitable calculation of any potential disallowance.

For example, suppose an employer provides a flight on the company plane for five employees from its headquarters location to destination A. At destination A, four of the employees attend business meetings, while one of the employees is commuting to destination A. Using the marginal cost approach (from § 274(m)(3)), only the marginal cost of providing the commuting flight for the employee commuting to destination A should be potentially subject to disallowance. In this scenario, the marginal cost of providing the commuting flight to the employee would be negligible, as there is no significant additional cost to adding one more passenger on a flight.

Finally, as explained in item #1 above, assuming the required amount is imputed to the employee for the commuting benefit, no portion of the cost of the flight provided to the employee should be subject to the disallowance.

4. Exception for Travel to Ensure the Safety of the Employee

Guidance should be provided on the exception in § 274(*l*) for commuting expenses that are necessary for the safety of the employee. Currently, in Treas. Reg. § 1.132-5(m)(2)(ii) and (iii), there is guidance on how to establish that a "bona fide business-oriented security concern" exists for an employee, and what qualifies as an "overall security program."

This existing guidance should be used to provide a "safe harbor" exception in § 274(*l*), to determine which flights would be deemed to be for purposes of ensuring the safety of the employee. For purposes of § 274(*l*), if the independent security study requires that the employee travel on the employer aircraft due to a bona fide business-oriented security concern, then such flights would meet the exception that they are being provided to ensure the safety of the employee. Flights which were not covered by an independent security study, or an overall security program, would be evaluated as necessary to ensure the safety of the employee based on all the facts and circumstances.

5. Section 274(*l*) Applies Only to Employees

It would be helpful to clarify the definition of "employee" for purposes of § 274(*l*)(1). The general definition of employee for purposes of the IRC is that which is provided for employment tax purposes. *See* Treas. Reg. § 31.3401(c)-1(b). Self-employed individuals, including independent contractors and partners, are generally not included in the definition of employee unless specifically provided by statute.

For example, § 129(e)(3) and 401(c) include self-employed individuals in the definition of employee for purposes of the dependent care assistance and qualified plan rules. Therefore, guidance should provide that the term "employee" does not include independent contractors or partners.

Guidance should also be provided to clarify that the term "employee" under § 274(*l*)(1) does not include 2% shareholders of Subchapter S corporations. Under § 1372, such shareholders are not employees for fringe benefit purposes. In Chief Counsel Advice 2003-44-008 (Jul. 1, 2003), the IRS further explained that 2% shareholders of Subchapter S corporations are not "employees" for purposes of § 274(e)(2) and the same analysis should apply under new § 274(*l*).

6. **No Effect on Qualified Business Use Under Section 280F(b)**

Under § 280F(b) there are special rules for an aircraft to qualify for accelerated depreciation. That section, and the regulations thereunder, provide that use of an aircraft in a trade or business of the taxpayer constitutes "qualified business use" for purposes of § 280F(b). *See* § 280F(d)(6)(B); Treas. Reg. § 1.280F-6(d)(2). Since § 280F(b) and 274(*l*) do not cross reference each other, it is clear that the amendment to add §274(*l*) under the TCJA should have no effect on the determination of "qualified business use" for purposes of §280F, but we would appreciate clarification of that point.