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subject: Whether a sole proprietor may use the primary purpose test to determine the deductibility of expenses for use of an aircraft owned by the sole proprietor.

This chief counsel advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Whether a taxpayer who operates a business as a sole proprietorship and owns an aircraft (either directly or indirectly through a disregarded entity) may utilize the primary purpose test in § 1.162-2(b)(1) of the Income Tax Regulations to determine the deductibility of expenses for use of the aircraft by the sole proprietor instead of applying the allocation methods in § 1.274-10(e).

CONCLUSION

A sole proprietor that owns an aircraft (either directly or indirectly through a disregarded entity) may use the primary purpose test in § 1.162-2(b)(1) to determine whether expenses for use of the aircraft by the sole proprietor are deductible. Sections

274(e)(2) and (9) of the Internal Revenue Code, and § 1.274-10 do not apply to expenses for use by a sole proprietor of an aircraft owned by the sole proprietor. However, limitations under other sections (and subsections) of the Code, including § 274(a)(1) for entertainment expenses and under § 274(m)(3) for travel expenses of a spouse, dependent, or others, may apply.

FACTS

Taxpayer is a sole proprietor and a Schedule C business owner who wholly owns and operates a business in either: (i) his or her own personal capacity, or (ii) through a single-member LLC which is disregarded as an entity separate from its owner for federal income tax purposes. The sole proprietor owns an aircraft either directly or indirectly through a single-member LLC and uses the aircraft to travel for business and entertainment purposes. Family members, friends, and business associates of the sole proprietor regularly travel with the sole proprietor on the aircraft.

LAW AND ANALYSIS

In general

Under § 162(a), taxpayers are generally allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 1.162-2(b)(1) provides that if a taxpayer travels to a destination and while at such destination engages in both business and personal activities, traveling expenses to and from such destination are deductible only if the trip is related primarily to the taxpayer's trade or business ("primary purpose test"). If the trip is primarily personal, the traveling expenses to and from the destination are not deductible; however, expenses at the location properly allocable to the taxpayer's trade or business are deductible.

Section 1.162-2(b)(2) provides that whether a trip is related primarily to the taxpayer's trade or business or is primarily personal in nature depends on the facts and circumstances in each case.

Section 1.162-2(c) provides that if a taxpayer's spouse (or any other family members) joins the taxpayer on a business trip, the expenses attributable to the spouse's travel are not deductible unless it can be adequately shown that the spouse's presence on the trip has a "bona fide" business purpose. The performance of any incidental service does not cause the spouse's expenses to be deductible.

In *Bruns v. Commissioner*, T.C. Memo. 2009-168, 2009 WL 2030886, at *11–*12 (July 14, 2009), the taxpayer claimed deductions for travel expenses related to trips having a

mixed business and pleasure motivation. The court noted that on these trips, taxpayer visited friends and relatives who were also customers and distributors in the taxpayer's business. Updating these customers and distributors about the new products and providing coaching on business leadership was business related. Visiting with friends and relatives about matters not related to the business was for pleasure. The court cited § 1.162-2(b)(1), (2) and (c), explaining that petitioners would be entitled to a deduction for expenses incurred at the location properly allocable to business activities. However, petitioners failed to provide sufficient information to allow any of the disallowed travel expenses.

Section 262(a) provides that, except as otherwise specifically provided in chapter 1 of the Code, no deduction is permitted for personal, living, or family expenses.

Section 1.262-1(b)(5) provides that expenses incurred in traveling away from home (which include transportation expenses, meals, and lodging) and any other transportation expenses are not deductible unless they qualify as expenses deductible under § 162 (relating to trade or business expenses), § 170 (relating to charitable contributions), § 212 (relating to expenses for production of income), § 213 (relating to medical expenses), or § 217 (relating to moving expenses), and the regulations under those sections.

Section 274 limits or disallows deductions for certain entertainment, meal, gift, and travel expenditures that otherwise would be allowable under chapter 1.

For amounts paid or incurred after December 31, 2017, § 274(a)(1)(A) disallows deductions for an activity generally considered to be entertainment, amusement, or recreation. Section 274(a)(1)(B) disallows deductions for facilities used in connection with an entertainment, amusement, or recreational activity, including aircraft.

For amounts paid or incurred prior to January 1, 2018, a deduction for 50% of expenses related to an entertainment facility was permitted under § 274(a)(1) and (n)(1)(B) if the taxpayer could establish that the item of expense was directly related to the active conduct of the taxpayer's trade or business. In the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), the item must be associated with the active conduct of the taxpayer's trade or business to be 50% deductible.

Section 274(m)(3) provides that no deduction shall be allowed under chapter 1 (other than § 217) for travel expenses paid or incurred with respect to a spouse, dependent, or other individual accompanying the taxpayer (or an officer or employee of the taxpayer) on business travel, unless the spouse, dependent, or other individual is an employee of the taxpayer; the travel of the spouse, dependent, or other individual is for a bona fide business purpose; and such expenses would otherwise be deductible by the spouse, dependent, or other individual.

Exceptions to section 274(a) and rules for “specified individuals”

Section 274(e)(2)(A) excepts expenses for goods, services, and facilities for entertainment from the § 274(a) disallowance to the extent that the expenses are treated by the taxpayer, with respect to the recipient of the entertainment, as compensation to the employee on the taxpayer’s returns and as wages to such employee for purposes of chapter 24 (withholding of income tax at source on wages). Section 274(e)(9) similarly excepts expenses to the extent that the expenses are includible in the gross income of a recipient of the entertainment who is not an employee of the taxpayer as compensation for services rendered or as a prize or award.

Section 274(e)(2)(B) provides that in the case of a “specified individual,” the § 274(e)(2)(A) and (9) exceptions to the § 274(a) disallowance apply only to the extent that the expenses do not exceed the amount of expenses that are treated as compensation to the specified individual.

Section 1.274-10(a)(1) provides that no deduction otherwise allowed under Chapter 1 is allowed for expenses for the use of a taxpayer-provided aircraft for entertainment, except as provided in § 1.274-10(a)(2).

Sections 1.274-10(a)(2)(ii)(A) through (C) provide exceptions to the disallowance of expenses for entertainment air travel for expenses treated as compensation to employees who are not specified individuals, non-employees who are not specified individuals, and specified individuals, respectively.

Section 1.274-10(e) provides rules for allocating expenses between the various individuals present on a flight with a specified individual and the character of each passenger’s use of the aircraft.

Application to sole proprietor

The exceptions to the disallowance of entertainment expenses in § 274(a) for expenses treated as compensation in § 274(e)(2) and (9) do not apply to a sole proprietor. In relevant part, § 274(e)(2) applies to the use of entertainment facilities by an employee of the taxpayer. A sole proprietor is not an employee of the sole proprietorship under the usual common law rules and does not receive compensation and wages from the sole proprietorship; rather, the sole proprietor is a self-employed individual for federal income tax purposes, and directly earns income from operating the business as an individual.

The use by a sole proprietor of an aircraft owned by the sole proprietor (directly or in a disregarded entity), whether for business or personal/entertainment use, does not result in compensation or imputed income, and cannot be reported as wages or as income. Hence, the exception from § 274(a) under § 274(e)(2) cannot apply to a sole proprietor.

Similarly, for purposes of § 274(e)(9), while the sole proprietor is a person "who is not an employee," the use of the sole proprietor's own aircraft by the sole proprietor is not "includible in the gross income of the (sole proprietor) recipient" as compensation or as a prize or award by the sole proprietorship. Therefore, the exception to § 274(a) under § 274(e)(9) cannot apply to the sole proprietor's use of the aircraft.

Because § 274(e)(2) and (9) do not apply to a sole proprietor, the allocation rules of § 1.274-10 promulgated thereunder have no application, and arguments concerning whether the taxpayer is or is not a specified individual are not relevant for these purposes.

Expenses for use by a sole proprietor of an aircraft owned by the sole proprietor may be deductible under § 162 based on the primary purpose test. If the primary purpose of a flight is personal rather than business, the expenses for the flight are not expenses paid or incurred in pursuit of the taxpayer's trade or business under § 162(a) and are nondeductible pursuant to § 262(a). The determination as to whether a mixed-use flight is a deductible business flight or a non-deductible personal flight is a facts and circumstances determination made under § 162 and the related regulations and case law.

Limitations for entertainment expenses may apply to deductions for the use by a sole proprietor of an aircraft owned by the sole proprietor. An allocation between business use and nondeductible entertainment use of an aircraft must be made using a reasonable method when deducting expenses, including depreciation, for a flight if any person on the flight engaged in entertainment activities during the associated trip. The primary purpose test is not applicable to this analysis and is not a reasonable method for this purpose. This allocation is required because § 274(a): (i) limits deductions for business entertainment use of an aircraft for amounts paid or incurred prior to January 1, 2018, (ii) disallows deductions for non-business entertainment use of an aircraft for amounts paid or incurred prior to January 1, 2018, and (ii) disallows deductions for any entertainment use of an aircraft for amounts paid or incurred after December 31, 2017. Deductions for the portion of the flight allocable to persons accompanying the sole proprietor may be further reduced under § 274(m)(3) and § 1.162-2(c).

This advice applies only under the facts and circumstances described herein.

Pursuant to section 6110(k)(3), this document may not be used or cited as precedent. Please call (202) 317-7005 if you have any further questions.