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IRS Chief Counsel memo: Treatment of expenses related to aircraft owned and used by sole proprietor

The IRS today publicly released a Chief Counsel memorandum* concluding that a sole proprietor that owns an aircraft (either directly or indirectly through a disregarded entity) may use the primary purpose test under Reg. section 1.162-2(b)(1) to determine whether expenses for use of the aircraft by the sole proprietor are deductible.

Read [CCA 202117012](#) [PDF 106 KB] (released April 30, 2021, and dated April 2, 2021)

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Background

The taxpayer—a sole proprietor and a Schedule C business owner—wholly owns and operates a business in either: (1) his or her own personal capacity, or (2) 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.

The question presented was whether the taxpayer may use the “primary purpose test” under Reg. section 1.162-2(b)(1) to determine the deductibility of expenses for use of the aircraft by the sole proprietor—instead of applying the allocation methods in Reg. section 1.274-10(e).

Chief Counsel memo conclusion and analysis

The Chief Counsel memo concludes that a sole proprietor who owns an aircraft (either directly or indirectly through a disregarded entity) may use the primary purpose test in Reg. section 1.162-2(b)(1) to determine whether expenses for use of the aircraft by the sole proprietor are deductible.

The CCA memo continues to explain that sections 274(e)(2) and (9) and Reg. section 1.274-10 do not apply to expenses for use by a sole proprietor of an aircraft owned by the sole proprietor, but that limitations under other sections—including section 274(a)(1) for entertainment expenses and section 274(m)(3) for travel expenses of a spouse, dependent or others—may apply.

The CCA memo explains that

- Reg. 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.
- Reg. 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.
- The exceptions to the disallowance of entertainment expenses in section 274(a) for expenses treated as compensation in section 274(e)(2) and (9) do not apply to a sole proprietor. 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 section 274(a) under section 274(e)(2) cannot apply to a sole proprietor.
- Similarly, for purposes of section 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 section 274(a) under section 274(e)(9) cannot apply to the sole proprietor's use of the aircraft. Because section 274(e)(2) and (9) does not apply to a sole proprietor, the allocation rules of Reg. section 1.274-10 do not apply and 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 section 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 section 162(a) and are nondeductible pursuant to section 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.
- 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.

- Deductions for the portion of the flight allocable to persons accompanying the sole proprietor may be further reduced under section 274(m)(3) and Reg. section 1.162-2(c).

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