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Special Report

AIRCRAFT USE REIMBURSEMENTS AND CHARGES: UNDERSTANDING THE REGULATORY REQUIREMENTS (FAA, IRS & SEC)

This article provides an analysis of the Federal Aviation Administration (FAA), Internal Revenue Service (IRS), and Securities and Exchange Commission (SEC) regulations regarding charges and reimbursements for noncommercial or private business aircraft use. Given that many companies have adopted aircraft use as an effective tool to increase productivity, efficiency, and security, it is extremely important that companies properly charge for the aircraft use to avoid violating federal law. Because a number of issues arise as companies try to allocate expenses, companies must have a thorough understanding of the applicable Federal Aviation Regulations (FARs) associated with intracompany flight operations.

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AIRCRAFT USE REIMBURSEMENTS AND CHARGES

FAR section 91.501[1] (Section 501) is the starting point for determining whether a particular charge or reimbursement is permissible. However, because Section 501 is complicated, a whole host of issues exist when Section 501 is read in the context of the complexities of modern business aircraft usage. Also, if a company fails to comply with the requirements of Section 501, the FAA may seek a civil penalty against the company in the amount of $25,000 per day, per flight for each FAR violation, which could easily exceed $100,000 per flight since each flight involves compliance with several FARs.[2] Fortunately, sufficient preplanning will often ensure regulatory compliance or enable companies to modify their existing flight operations to ensure FAR compliance.

The problem of charging or reimbursing for aircraft use arises because only specific entities may charge or seek reimbursement for specific expenses under limited circumstances. As with any regulatory interpretation, the appropriate starting place is the regulation and related guidance. Section 501(b)(5) provides that a company may conduct noncommon carriage[3] under FAR part 91, subpart F, when:

> Carriage of officials, employees, guests, and property of a company on an airplane operated by that company, or the parent or a subsidiary of the company or a subsidiary of the parent, when the carriage is within the scope of, and incidental to, the business of the company (other than transportation by air) and no charge, assessment or fee is made for the carriage in excess of the cost of owning, operating, and maintaining the airplane, except that no charge of any kind may be made for the carriage of a guest of a company, when the carriage is not within the scope of, and incidental to, the business of that company.[4]

I. FAA Issues: Intracompany Operations

The failure to comply with the FARs poses the greatest regulatory risk to companies for improperly charging for air transportation. As a result, it is important to note that Section 501(b)(5) must be read in the context of two very important rules of statutory construction. First, the FAA has stressed that Section 91.501 is to be strictly construed, which means that any doubt regarding whether a company may seek reimbursement for intracompany aircraft use should be resolved in favor of the company's either refraining from seeking reimbursement or obtaining the appropriate air carrier certificate and conducting operations as a "commercial operator"[5] typically under Part 135.[6]

The second rule is the Plain Meaning Rule, which provides that when language or terms are clear, they must be interpreted as what language or terms plainly express.[7] For example, the word "company" in Section 501(b)(5) means a company as opposed to a natural person.[8] Likewise, the terms "the parent" and "a subsidiary" mean exclusively *the* parent or *a* subsidiary company, and probably not a parent's parent company or a subsidiary's subsidiary company.[9]

Finally, with respect to tax issues, companies must also be aware that the FAA's interpretation of Section 501 is not dependent upon IRS regulations.[10] A common mistake companies make is to confuse FAA and IRS regulations. However, the FAA is not concerned about tax consequences associated with aircraft use, and these differing regulatory stances pose potential problems to those companies that mistakenly believe that the FAA's position is consistent with the IRS's position. This is a particular concern since some reimbursements are subject to federal excise tax (FET). As a practical matter, the FAA's primary concern is safety, not tax issues, and when in doubt as to whether reimbursement may be sought, the FAA will always advise companies to either refrain from seeking reimbursement or obtain the appropriate air carrier certificate.

Such advice, however, fails to address the realities of business aircraft operations, including the impact that such advice has in terms of the increased costs and reduced operating capabilities associated with operating under Part 135 as opposed to Part 91. More importantly, no reason exists for a company to obtain an expensive Part 121 or 135 air carrier certificate when a company's flight operations fall exclusively within the ambit of Section 501.

A. Flight Department Companies

In an effort to limit liability, many companies often make the mistake of creating a separate flight department special purpose entity (SPE) whose sole business function is the ownership and operation of aircraft. Typically, the SPE owns the aircraft, employs pilots, leases the aircraft with crew (a wet lease) to other members of the corporate family, and then seeks reimbursement. However, a SPE flight department is problematic because the SPE's flights are not incidental to the business of the company. Rather, the flights are the SPE's major enterprise or primary business purpose[11] for which it receives compensation.[12] According to the FAA, such an operation falls squarely within the definition of a commercial operator.

The prohibition against flight department SPEs also extends to individuals who own aircraft solely for personal use and then set up a flight department company. A good example would be an executive of a company who owns an aircraft for his personal use, who is then solicited by the company to use the aircraft for company business and is then reimbursed. The executive would have to create an SPE because individuals are prohibited from receiving reimbursement and, in doing so, the executive would have created a flight department SPE, in violation of the FARs.[13]

Little doubt exists that the FAA would view such an entity as operating as an entity for compensation or hire for which an appropriate operating certificate would be required. One solution would be to establish a flight department division within a parent or subsidiary, thus avoiding the creation of an SPE. As a practical matter, any potential reduced liability sought by the creation of the flight department SPE must be weighed against the likelihood of whether an insurance company would honor a policy in the event of an accident, since the policyholder is likely operating in violation of the FARs.

B. "Within the Scope of, and Incidental to"

Before a company may seek reimbursement for expenses associated with a given flight, the company must determine whether the transportation is within the scope of, and incidental to, the business of that company or its parent or subsidiary, or its parent's subsidiary.[14] Specifically, Section 501(b)(5) provides that a company may charge for the carriage of a company's officials, employees, guests, or property on a company aircraft only when carriage is within the scope of, and incidental to, the business of the aircraft owner/operator, its parent or its subsidiary, or its parent's subsidiary.[15] If the transportation is not within the scope of, and incidental to, the business of that company, a company may still perform the flight under Part 91, but it may not seek reimbursement for expenses.

The determination of whether a company's carriage of persons or property is within the scope of, and incidental to, the company's business must be made on a case-by-case basis after the facts have been evaluated in the context of the company's business.[16] Clearly, for purposes of Section 501(b)(5), not all of a company's transportation is within the scope of, and incidental to, a company's business. While the FAA has provided little guidance on the subject, some guidance may be gleaned from a few FAA Chief Counsel Interpretations, preambles to the Notice of Proposed Rulemaking (NPRM) and the Final Rule (FR), as well as subsequent amendments.

1. Vacation, Pleasure, or Similar Carriage

The FAA's policy is that vacation, pleasure, or similar carriage is not within the scope of, and incidental to, the business of a company. Specifically, in a Chief Counsel Interpretation, the FAA concluded that an executive was prohibited from reimbursing the company for the carriage for vacation, pleasure, or similar purposes.[17] The company claimed that the chief executive officer's (CEO) use of aircraft allowed it to maintain prompt communications with the vacationing executive and, therefore, the carriage *was* within the scope of the company's business, which was financial planning and investing.[18] The FAA rejected the company's position with respect to the need for prompt communications and stressed that it did not alter the fact that the CEO was traveling for *pleasure*, which is not within the scope of, and incidental to, the company's business.[19] The FAA added that ability to communicate with the CEO was in no way dependent upon charging him for carriage for such purposes.[20]

Obviously, in view of the FAA's position on the issue of vacation, pleasure, or similar travel, a company should not seek reimbursement for such travel. However, with sufficient preplanning it might be possible to incorporate some business at the vacation destination, such as a client meeting, which in turn may make the carriage, at least in part, business. In that case, such a determination should be made only after consulting with a knowledgeable aviation attorney. Also, as discussed below, executives may reimburse the company for personal use of the company aircraft pursuant to a time-sharing agreement.

2. Specialized Private Carriage and Profit Motive

The FAA issued an extremely narrow interpretation of "within the scope of, and incidental to" when it addressed whether the carriage of a national for-profit child care agency's staff and its children clients in connection with its counseling program was within the scope of, and incidental to, the agency's principal business purpose.[21] The agency proposed to charge the city of Oakland, California, a flat fee per trip to transport the children from Oakland to the agency's headquarters located in Tucson, Arizona.[22] The interpretation did not address whether the flat fee was associated with the cost of owning, operating, or maintaining the aircraft.

The FAA concluded that the agency's carriage of the children would not be incidental to its business, but rather a "specialized form of private carriage" for compensation or hire for which an appropriate operating certificate would be required, and that the carriage of its staff would be incidental to its business.[23] What is interesting about the FAA's handling of this example is that the FAA ignored the express language of "within the scope of, and incidental to" and created a new form of carriage, i.e., "specialized private carriage." Clearly, the agency's carriage of children would have been within the scope of, and incidental to, its primary business purpose, which was child counseling. Such an interpretation arguably extends beyond a strict interpretation of Section 501(b)(5).

One reason for the FAA's position in this interpretation may stem from the fact that the agency was a for-profit entity and that the reimbursement originated from outside the corporate family. While Section 501(b)(5) does not prohibit such reimbursements, it appears that the FAA was troubled by that fact and that the flat fee was not specifically associated with the costs of owning, operating, and maintaining the aircraft. In the preamble to the Final Rule (FR), which expanded the use of company aircraft to a company's parent or subsidiary or a parent company's subsidiary, the FAA stated that it "does not believe that there would be a profit motive in connection with dealings *within a corporate family*…" (emphasis added).[24]

As a result, it is conceivable that the FAA would take the position that a profit motive exists simply because the reimbursement originates outside the corporate family. In the above example, it is conceivable that the FAA's decision would have been different if the reimbursement originated from within the corporate family or if the flat fee was tied directly to the costs of owning, operating, and maintaining the aircraft. Still, companies must be mindful of the perceptions involved with similar reimbursements, particularly if the reimbursements originate outside the corporate family and involve the carriage of guests.

3. Transportation of Goods

A company aircraft used for the carriage of the company's goods to and from its plants would likely be considered within the scope of, and incidental to, the business of the company.[25] In the preamble to the Notice of Proposed Rule Making (NPRM), the FAA distinguished carriage of goods during the processing stage, but in the FR rejected the distinction. Specifically, in the NPRM preamble the FAA stressed:

> Some operators, however, have attempted to use [the major enterprise or primary business test] as a means of circumventing the application of commercial operator rules of Part 121 to their operations. This is particularly true in the case of the so-called meat or lobster haulers who allege that their primary business is the processing and sale of meat and lobsters, when in actuality it is the carriage of such products by airplane, for their own account, to a place where it is sold for a substantial profit.[26]

In the FR, the FAA explained that it will permit the carriage of property (other than mail) on an airplane operated by a person in the furtherance of a business (other than transportation), when the carriage is incidental to that business and no charge is made for that carriage in excess of the normal operating expenses of the flight.[27] However, the FAA stressed that this change in policy from the NPRM permits a greater use of an airplane, but it does not change the FAA's stance on whether the carriage of goods or property is the primary business of the operator of that airplane. When the carriage is in fact a major enterprise, an air carrier operating certificate under Part 121 or Part 135, as appropriate, is required.[28]

4. Carriage of Guests

The carriage of distributors of a company's products, or guests for the purposes of Section 501(b)(5), to a company facility for training sessions, as long as no sales were conducted or arranged,[29] would be covered by the meaning of "within the scope of, and incidental to, the business of the company."[30] With respect to guests, Section 501(b)(5) is quite clear that "no charge of any kind may be made for the carriage of a guest of a company, when the carriage is not within the scope of, and incidental to, the business of that company."[31] Section 501(b)(5) also does not differentiate between company guests and employee guests. Any person on the aircraft who is not a company official or employee is a guest, and only if that person's presence on the aircraft is within the scope of, and incidental to, the business of that company, may the company accept reimbursement.

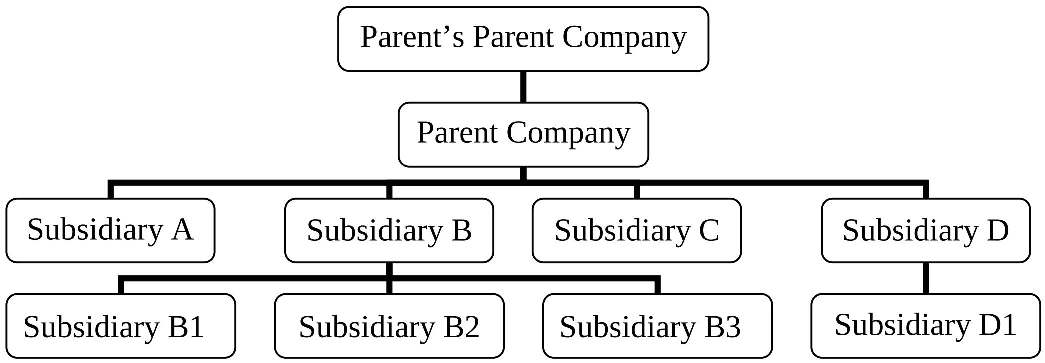
C. Overview

Given the complexities of Section 501(b)(5), a company could establish that certain carriage is within the scope of, and incidental to, the business of the company by a board of directors' resolution that explains why the carriage at issue was within the scope of, and incidental to, the business of that company.[32] Given the complexities of most business carriage, including the differences in the nature of each company's operations, it is virtually impossible to create a "within the scope of, and incidental to" test. Suffice it to say, the best starting point is to establish a thorough understanding of the intricacies of Section 501(b)(5) and what impact they may have upon a company's flight operations. Otherwise, significant negative consequences exist, such as FAA civil penalties and FET payments.

II. Parent-Subsidiary Relationship

Section 501(b)(5) applies only to the company operating the aircraft, or its parent or subsidiary, or a subsidiary of the parent.[33] Repercussions are severe for flights conducted outside the narrowly defined parent-subsidiary relationship, including civil penalty, denial of insurance and tort liability in the event of an accident or incident. The FAA's perspective of the parent-subsidiary relationship is unique in that the FAA does not recognize indirect parents or subsidiaries. Specifically, Section 501(b)(5) uses the term "*the* parent" as opposed to "a parent," which suggests that the FAA will

FIGURE 1.



recognize only *one* parent company. The FAA also makes clear that there must be objective evidence of a true parent-subsidiary relationship.[34]

Consistent with a narrow interpretation of the regulation, the FAA contends that the entity receiving the reimbursement (i.e., the company, the parent, or a subsidiary) must be a company as opposed to an individual.[35] This stance, in all likelihood, stems from the FAA's narrow interpretation of the term "company" in Section 501(b)(5).

Similarly, Section 501(b)(5) does not permit reimbursements from "sister companies" unless the sister companies share the same parent subsidiary relationship. Sister companies that share a degree of ownership and management, which may be functionally as great as those of a parent-subsidiary, companies do not fall within the ambit of Section 501(b)(5).[36] In addition, stock ownership is not the standard upon which a parent-subsidiary relationship is determined. For example, the FAA concluded in a Chief Counsel Interpretation that a company, Company P, was not the parent company of a second company, Company S, simply because Company P owned 25 percent of Company S's stock and Company P's sole owner was a director of Company S.[37] In rejecting Company P's claim that its 25 percent stock ownership was sufficient for it to have a degree of control over Company S, the FAA stated that to establish such a relationship, "there must be objective evidence which establishes that a parent subsidiary plan exists" beyond stock ownership.[38]

Moreover, given the complexities of various corporate structures, a clearly identifiable organizational relationship must exist between the company and its parent or subsidiary, or between the parent and subsidiary, with evidence that the parent exerts a degree of control over its subsidiary.[39] Theoretically, a vertical organization structure would be preferable to a horizontal organization structure, unless a company takes advantage of the "or a subsidiary of the parent" condition. To illustrate, assume that a subsidiary, such as Subsidiary B in Figure 1, owns and operates an aircraft and its parent company has several other subsidiaries. Subsidiary B would be able to seek reimbursement from every entity, with the exception of the Parent's Parent Company and Subsidiary D1.

Unfortunately, the FAA failed to expand on the meaning of "a parent subsidiary plan," and there is no indication how the FAA would have responded if Company P owned 50 percent of Company S's voting stock. Despite the FAA's unwillingness to recognize the significance of stock ownership, according to *Black's Law Dictionary*, a parent company is a "Company owning more than 50 percent of the voting shares, or otherwise a controlling interest, of another company, called the subsidiary."[40] In short, it would be quite difficult for the FAA to defend such a position if a company with greater than 50 percent ownership in another subsidiary company decides to operate as the subsidiary's parent company under Section 501(b)(5).

The FAA has, however, taken the position that a company, Company P, could not seek reimbursement from other entities in a group of family-owned companies engaged in a common business.[41] Specifically, the facts involved twelve family-owned companies that engaged in retail and wholesale lumber operations, maintained their headquarters at the same location, and all had a need to use the aircraft.[42] After reviewing a listing of the owners, officers, general partners, limited partners, and directors for the twelve affiliated companies, the FAA concluded that no corporate parent or subsidiary relationship existed among the twelve companies, although the principals of Company P served in various official capacities within the other companies.[43] The FAA stressed that "each company appears to be autonomous, being controlled by different combinations of directors, owners, and parties" and, therefore, could not operate under Section 501(b)(5).[44] The FAA added that Section 501(b)(5) "was devised specifically for companies that have a corporate parent subsidiary relationship, whose aircraft are used for the carriage within the scope of, and incidental to, the business of the company."[45]

Although the FAA has yet to address the issue of whether the parent and subsidiary must be in the same line of business, the above example suggests that being in the same line of business is not a relevant factor in determining whether a parent-subsidiary relationship exists. Accordingly, it is unlikely that the FAA would ever place such a restrictive requirement on Section 501(b)(5). Significantly, such a restriction would severely hamper the ability of companies to conduct flight operations under Section 501(b)(5), would not be supported by the regulatory history, and would probably be deemed arbitrary and capricious if ever challenged.

In sum, it is important to note that the parent-subsidiary relationship is strictly construed, and sufficient evidence to establish organizational control must exist. The FAA may only recognize *the* parent company and its subsidiaries as opposed to *a* parent company (i.e., an indirect parent company) and its subsidiaries (i.e., sister companies). A company that merely owns stock, or has a controlling interest, in a company would probably not be characterized as a parent company, absent sufficient evidence of organizational control over a subsidiary. Likewise, an entity that merely makes a profit for another company would not be a subsidiary absent sufficient evidence of organizational control. Again, given the complexities of any given company's situation, when in doubt, a company should present its unique situation to a knowledgeable aviation attorney, who should be able to advise the company as to the best course of action.

III. Reimbursable Expenses

The most important aspects of expense reimbursements are understanding what expenses may be reimbursed, by whom, and when.

A. Intracompany Operations

The expenses for which a company may seek reimbursement are limited to those expenses directly related to the costs of owning, operating, and maintaining the aircraft.[46] Because the nature of the expenses varies with each company and aircraft, the FAA has chosen not to create a comprehensive list of expenses.[47] Instead, the FAA has stated that the expenses may be those commonly identified by a company's accounting department as expenses associated with the use of the aircraft.[48] At a minimum, the costs of owning, operating, and maintaining an aircraft should include a pro rata portion of all fixed and variable overhead costs.[49] Common examples of fixed operating costs include: crew salaries, hangar, insurance, recurrent training, aircraft modernization, refurbishment, and a computer maintenance program. Common examples of direct costs include: fuel, fuel additives, lubricants, maintenance labor, parts (airframe/engine/avionics), engine restoration, thrust reverser overhaul, APU overhaul, and landing and parking expenses.

In addition to the foregoing expenses, an argument could be made for the inclusion of a wide variety of expenses associated with owning, operating, and maintaining an aircraft, such as capital costs (e.g., interest expenses) and market depreciations. However, such a position would be somewhat aggressive, since the FAA has yet to address the issue, and the consequences may include a hefty civil penalty and an FAR violation.

B. Personal Use of Business Aircraft

As a general rule, the FAA prohibits any reimbursement for personal use of business aircraft unless the travel is provided by a certificated air carrier. However, the FAA recently issued guidance clarifying that reimbursements are permissible under FAR part 91 for employee personal use pursuant to a time-sharing agreement. A time-sharing agreement is an arrangement whereby a company leases its aircraft with flight crew to another person or company, and no charge is made for the flights conducted under the arrangement other than approximately the direct operating expense plus 100 percent of the fuel expense. A company may charge less than the associated charges under a time-sharing agreement, but it may not charge more.

Reimbursements, via time-sharing agreements, have increased in popularity following passage of the Sarbanes-Oxley Act of 2002 (SOX)[50] and increased public scrutiny. There are four important issues to consider with time-sharing agreements. First, the lessor always possesses operational control and therefore faces the regulatory and litigation exposure in the event of an accident or incident. Second, the reimbursement amount is based on each specific flight and may be determined only after the flight based on the direct operating costs. Third, an executive's reimbursement does not necessarily mean that a company should disregard the IRS and SEC regulations applicable to business aircraft use as discussed below. Fourth, federal excise taxes apply to the time-sharing agreement payments because the IRS considers time-sharing agreements to be commercial transactions, while the FAA considers them noncommercial.

IV. IRS and SEC Issues

Reimbursements are generally a positive thing from an IRS and SEC perspective because the agencies are concerned with imputed income and perquisites, respectively. An executive's reimbursement for her or his personal use of the aircraft in most cases eliminates the imputed income or the reportable benefit to the executive.

A. IRS Issues

Personal use of the aircraft is considered a taxable fringe benefit and the value of such use is calculated at the Standard Industry Fare Level (SIFL), (a per-mile rate issued periodically by the IRS, multiplied by aircraft size factor and employee position). For all practical purposes, the IRS does not recognize spousal or family travel in conjunction with a business flight unless the spouse's or family's presence is deemed to be for a legitimate business purpose. To the extent that the spouse's presence is not deemed to be for a legitimate business purpose, the sponsoring employee will be subject to imputed income equal to the SIFL value of the benefit received. Family travel not associated with a business-sponsored spousal event is considered personal use. IRS regulations, however, allow guests to travel without any imputed income to the host if more than 50 percent of the aircraft seats are filled on a single flight by those with a valid business purpose. Any remaining seats may be used by employees, spouses and children traveling for nonbusiness reasons without assigning a value to that transportation.

In most cases, the reimbursements under a time-sharing agreement will exceed the SIFL rate, but it is possible, if the executive reimburses an amount less than the maximum amount and the executive has several guests on the flight, that the SIFL amount may exceed the reimbursement. As a result, it would be wise to calculate the SIFL rate to confirm no imputed income is necessary. Also, as noted above, because the IRS considers time-sharing agreements to be commercial transactions, the executive must pay federal excise taxes on the reimbursements.

B. SEC Issues

The SEC is responsible for ensuring full and accurate disclosure of executive compensation. SEC rules require that publicly traded companies disclose to the public (typically in its Proxy) the aggregate incremental cost to the company of employees' personal use of aircraft benefits received (including accompanying relatives and guests), pursuant to Item 402 of Regulation S-K (17 C.F.R. § 209.402). Item 402 provides in relevant part:

> If the total value of all perquisites and personal benefits is $10,000 or more for any named executive officer, then each perquisite or personal benefit, regardless of its amount, must be identified by type. If perquisites and personal benefits are required to be reported for a named executive officer pursuant to this rule, then each perquisite or personal benefit that exceeds the greater of $25,000 or 10 percent of the total amount of perquisites and personal benefits for that officer must be quantified and disclosed in a footnote. The requirements for identification and quantification apply only to compensation for the last fiscal year. Perquisites and other personal benefits shall be valued on the basis of the aggregate incremental cost to the registrant.
>
> With respect to the perquisite or other personal benefit for which footnote quantification is required, the registrant shall describe in the footnote its methodology for computing the aggregate incremental cost. Reimbursements of taxes owed with respect to perquisites or other personal benefits must be included in column (i) and are subject to separate quantification and identification as tax reimbursements even if the associated perquisites or other personal benefits are not required.[51]

Although business aircraft use has been under increased scrutiny following the enactment of SOX, given the crises in the financial and automobile sectors, business aircraft use, particularly personal use, has become a favorite target for the media, politicians, and activist shareholders to cite as an example of corporate waste, abuse, and management irresponsibility. As a result, several companies have implemented policies to require their executives to limit such use or reimburse their companies for any use that exceeds a specific threshold. Notwithstanding the good intentions, companies often fail to realize that the only way for an executive to reimburse the company is with a time-sharing agreement, and a time-sharing agreement cannot be implemented retroactively because of the FAA's truth-in-leasing reporting requirements.

Assuming the company has executed a time-sharing agreement with the executive, as is the case with the IRS's imputed income, an executive's reimbursements will likely exceed the aggregate incremental costs to the company for the flight depending on how the company determines the aggregate incremental costs. However, the aggregate incremental cost is usually much more than the SIFL rate. While the SEC has not provided specific guidance regarding how a company should determine aggregate incremental costs or describe the footnote methodology, companies generally calculate the direct operating costs using standard industry aircraft expenses. Finally, a time-sharing agreement may have to be reported as a related transaction in accordance with Item 404 (17 C.F.R. § 209.404) if the reimbursement exceeds $120,000.

V. Enforcement Risks

The first indication that the company may have FAA troubles is a visit from an FAA inspector and the receipt of a Letter of Investigation (LOI), which requires the company to respond within 10 days. A word of caution: all information submitted in response to the LOI will be used to support the FAA's enforcement case, and the information will likely be subject to public disclosure under the Freedom of Information Act. In any event, if after the company responds to the LOI the FAA believes that a company violated the FARs, the company may be subject to a significant civil penalty, which may easily exceed $100,000, and the FAA has the option to issue a press release. Prior to the issuance of any proposed civil penalty, the FAA will assess the company's attitude, its size, the nature of the violation, and the associated enforcement guidance.[52] In the case of Section 501(b)(5), the only guidance available is the regulation, regulatory history, and Chief Counsel Interpretations. While Chief Counsel Interpretations are not enforceable documents, they are a means by which the FAA may disseminate information concerning its enforcement and regulatory policies.

Nevertheless, it is a general principle of administrative law that a reviewing judge will defer to the FAA's interpretation of its regulations unless its interpretation is arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law. In the case of Section 501(b)(5), as currently interpreted by the FAA, there does not appear to be any aspect that would be vulnerable to such a challenge. Lastly, if the legitimacy of Section 501(b)(5) is ever challenged, the FAA would probably not hesitate to create new law in this area at the expense of a company that the FAA believes is operating in violation of Section 501(b)(5).

VI. Conclusion

While the FARs allow companies to use aircraft to increase productivity, efficiency, and security for their executives and employees, it is important that companies possess a thorough understanding of the FAA, IRS, and SEC regulations to ensure compliance. In particular, understanding the meaning of "within the scope of, and incidental to" is key to conducting intracompany operations under Section 501(b)(5). As long as companies ensure that any transportation is within the scope of, and incidental to, the company's business before any reimbursement is sought, and that the reimbursements are limited between parent and subsidiary companies, a company should be able to operate under Section 501(b)(5). Also, with respect to personal use reimbursements, a time sharing agreement is required. Finally, when in doubt, a company should read the FARs very carefully, consult a knowledgeable aviation attorney, and, with the aid of the aviation attorney, determine whether reimbursement may be sought, and what if any impact of the reimbursements would have on the associated IRS and SEC regulations.

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End Notes

1 Formerly 14 C.F.R. § 91.181(b)(5).

2 *See* 49 U.S.C. § 46310 (2006), 14 C.F.R. § 13, subpart H (2009). The FAA would likely deem a flight operated in violation of FAR Part 91 to constitute a Part 135 flight. Accordingly, the operator of the flight would also have to comply with (and therefore be considered to have violated) several of the associated Part 135 requirements.

3 FAR § 119.3 provides: "Non common carriage means an aircraft operation for compensation or hire that does not involve a holding out to others." 14 C.F.R. § 119.3 (2000).

4 14 C.F.R. § 91.501(b)(5) (2006).

5 FAR § 1.1 provides: "Commercial operator means a person who, for compensation or hire, engages in the carriage by aircraft in air commerce of persons or property, other than as an air carrier or foreign air carrier under the authority of Part 375 of this title. Where it is doubtful that an operation is for 'compensation or hire,' the test applied is whether the carriage by air is merely incidental to the person's other business or is, itself, a major enterprise or profit." 14 C.F.R. § 1.1 (2006).

6 Interpretation 1992-42, 3 Fed. Av. Dec. I-273 (June 10, 1992); Interpretation 1975-16, 1 Fed. Av. Dec. I-28 (Apr. 4, 1975).

7 Interpretation 1989-22, 2 Fed. Av. Dec. I-241 (Aug. 8, 1989).

8 Interpretation 1990-11, 2 Fed. Av. Dec. I-280 (May 24, 1990).

9 Interpretation 1979-1, 1 Fed. Av. Dec. I-326 (Jan. 2, 1979).

10 Interpretation 1993-17, 4 Fed. Av. Dec. I-42 (Aug. 2, 1993).

11 Interpretation 1989-22, 2 Fed. Av. Dec. I-241; Interpretation 1975-15, 1 Fed. Av. Dec. I-27 (Apr. 4, 1975).

12 A profit is not necessary to constitute compensation, and a company that is reimbursed only for its operating expenses performs its services for compensation. 36 Fed. Reg. 19,508.

13 Private pilots should also be mindful of the limitations of acting as pilot in command when the carriage involves carrying passengers or property for compensation or hire. 14 C.F.R. § 61.113 (2006).

14 Interpretation 1992-42, 3 Fed. Av. Dec. I-275.

15 Interpretation 1985-9, 2 Fed. Av. Dec. I-305 (May 31, 1985).

16 Interpretation 1990-11, 2 Fed. Av. Dec. I-305.

17 Interpretation 1993-17, 4 Fed. Av. Dec. I-41.

18 *Id.* at I-42.

19 *Id.*

20 *Id.*

21 Interpretation 1984-12, 2 Fed. Av. Dec. I-17 (May 22, 1984).

22 *Id.* at I-17.

23 *Id.* at I-18.

24 37 Fed. Reg. 22,799 (Oct. 25, 1972).

25 36 Fed. Reg. 19,508 (Oct. 7, 1971).

26 36 Fed. Reg. 19,508.

27 37 Fed. Reg. 14,760.

28 *Id.*

29 The introduction of sales or any other such activity would likely be perceived as carriage for the purpose of selling goods or property, and reimbursement would be prohibited. Specifically, Section 91.501(b)(9) prohibits companies from charging for carriage of persons other than company employees in furtherance of a business other than for the transportation by air for the purpose of selling land, goods, or property, including franchises or distributorships. 14 C.F.R. § 91.501(b)(9)(2006).

30 Interpretation 1984-6, 2 Fed. Av. Dec. I-8 (Apr. 2, 1984).

31 Interpretation 1977-80, 1 Fed. Av. Dec. I-271 (Dec. 16, 1977).

32 Interpretation 1992-42, 3 Fed. Av. Dec. I-273. In addition to a board resolution, a company could also ensure that the minutes of any meeting regarding aircraft usage reflect a thorough discussion explaining why a particular carriage was within the scope of, and incidental to, the company's business.

33 Interpretation 1975-13, 1 Fed. Av. Dec. I-24 (Apr. 1, 1975).

34 Interpretation 1985-17, 2 Fed. Av. Dec. I-71 (July 16, 1985).

35 Interpretation 1990-18, 2 Fed. Av. Dec. I-305 (July 13, 1990); Interpretation 1990-11, 2 Fed. Av. Dec. I-228; Interpretation 1979-1, 1 Fed. Av. Dec. I-326.

36 Interpretation 1975-13, 1 Fed. Av. Dec. I-24, 25.

37 Interpretation 1985-17, 2 Fed. Av. Dec. I-71.

38 Interpretation 1985-17, 18, 2 Fed. Av. Dec. I-71.

39 Interpretation 1975-13, 1 Fed. Av. Dec. I-24.

40 Black's Law Dictionary, 1114 (6th ed. 1990).

41 *In re Sutherland Lumber & Material Co.*, Denial of Exemption (Dep't Transp., May 26, 1978).

42 *Id.*

43 *Id.*

44 *Id.*

45 *Id.*

46 The charges would be subject to Federal Excise Tax if the company does not meet the requirements of Internal Revenue Code Section 4282 regarding an exemption for affiliated groups.

47 To avoid any confusion, it is also important to note that a company operating a flight under Section 501(b)(5) cannot use the expenses identified in Section 91.501(d) as a basis to determine the allowable expenses of a specific flight, since those expenses are limited to flights conducted under Sections 91.501(b)(3), (b)(7), and (c)(1). Interpretation 1992-42, 3 Fed. Av. Dec. I-278.

48 Interpretation 1985-10, 2 Fed. Av. Dec. I-60 (June 5, 1985); 14 C.F.R. § 91.501(b)(5).

49 *See* Interpretation 1992-42, 3 Fed. Av. Dec. I-277, 278; Interpretation 1990-11, 2 Fed. Av. Dec. I-289; Interpretation 1985-10, 2 Fed. Av. Dec. I-60; Interpretation 1985-9, 2 Fed. Av. Dec. I-305.

50 Pub. L. 107-204, 116 Stat. 745, enacted July 30, 2002.

51 17 C.F.R. § 209.402(c)(2)(ix), Instructions to Item 402(c)(2)(ix).

52 *See* FAA Order 2150.3B, Department of Transportation, Federal Aviation Administration, Compliance and Enforcement Program (Oct. 1, 2007).

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