

### **Reg. Section 1.274-10(d)(3)(i)**

Special rules for aircraft used for entertainment.

(a) Use of an aircraft for entertainment -- (1) In general. Section 274(a) disallows a deduction for certain expenses for entertainment, amusement, or recreation activities, or for an entertainment facility. Under section 274(a) and this section, no deduction otherwise allowable under chapter 1 is allowed for expenses for the use of a taxpayer-provided aircraft for entertainment, except as provided in paragraph (a)(2) of this section.

(2) Exceptions -- (i) In general. Paragraph (a)(1) of this section does not apply to deductions for expenses for business entertainment air travel or to deductions for expenses that meet the exceptions of section 274(e), § 1.274-2(f), and this section. Section 274(e)(2) and (e)(9) provides certain exceptions to the disallowance of section 274(a) for expenses for goods, services, and facilities for entertainment, recreation, or amusement.

(ii) Expenses treated as compensation -- (A) Employees who are not specified individuals. Section 274(a), § 1.274-2(a) through (d), and paragraph (a)(1) of this section, in accordance with section 274(e)(2)(A), do not apply to expenses for entertainment air travel provided to an employee who is not a specified individual to the extent that a taxpayer--

(1) Properly treats the expenses relating to the recipient of entertainment as compensation to an employee under chapter 1 and as wages to the employee for purposes of chapter 24; and

(2) Treats the proper amount as compensation to the employee under § 1.61-21.

(B) Persons who are not employees and are not specified individuals. Section 274(a), § 1.274-2(a) through (d), and paragraph (a)(1) of this section, in accordance with section 274(e)(9), do not apply to expenses for entertainment air travel provided to a person who is not an employee and is not a specified individual to the extent that the expenses are includible in the income of that person. This exception does not apply to any amount paid or incurred by the taxpayer that is required to be included in any information return filed by the taxpayer under part III of subchapter A of chapter 61 and is not so included.

(C) Specified individuals. Section 274(a), § 1.274-2(a) through (d), and paragraph (a)(1) of this section, in accordance with section 274(e)(2)(B), do not apply to expenses for entertainment air travel of a specified individual to the extent that the amount of the expenses do not exceed the sum of--

(1) The amount treated as compensation to or included in the income of the specified individual in the manner specified under paragraph (a)(2)(ii)(A)(1) of this section (if the specified individual is an employee) or under paragraph (a)(2)(ii)(B) of this section (if the specified individual is not an employee); and

(2) Any amount the specified individual reimburses the taxpayer.

(iii) Travel on regularly scheduled commercial airlines. Section 274(a), § 1.274-2(a) through (d), and paragraph (a)(1) of this section do not apply to expenses for entertainment air travel that a taxpayer that is a commercial passenger airline provides to specified individuals of the taxpayer

on the taxpayer's regularly scheduled flights on which at least 90 percent of the seats are available for sale to the public to the extent the expenses are includible in the income of the recipient of the entertainment in the manner specified under paragraph (a)(2)(ii)(A)(1) of this section (if the specified individual is an employee) or under paragraph (a)(2)(ii)(B) of this section (if the specified individual is not an employee).

(b) Definitions. The definitions in this paragraph (b) apply for purposes of this section.

(1) Entertainment. For the definition of entertainment for purposes of this section, see § 1.274-2(b)(1). Entertainment does not include personal travel that is not for entertainment purposes. For example, travel to attend a family member's funeral is not entertainment.

(2) Entertainment air travel. Entertainment air travel is any travel aboard a taxpayer-provided aircraft for entertainment purposes.

(3) Business entertainment air travel. Business entertainment air travel is any entertainment air travel aboard a taxpayer-provided aircraft that is directly related to the active conduct of the taxpayer's trade or business or related to an expenditure directly preceding or following a substantial and bona fide business discussion and associated with the active conduct of the taxpayer's trade or business. See § 1.274-2(a)(1)(i) and (ii). Air travel is not business entertainment air travel merely because a taxpayer-provided aircraft is used for the travel as a result of a bona fide security concern under § 1.132-5(m).

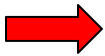
(4) Taxpayer-provided aircraft. A taxpayer-provided aircraft is any aircraft owned by, leased to, or chartered to, a taxpayer or any party related to the taxpayer (within the meaning of section 267(b) or section 707(b)).

(5) Specified individual. For rules relating to the definition of a specified individual, see § 1.274-9.

(c) Amount disallowed. Except as otherwise provided, the amount disallowed under this section for an entertainment flight by a specified individual is the amount of expenses allocable to the entertainment flight of the specified individual under paragraph (e)(2), (e)(3), or (f)(3) of this section, reduced (but not below zero) by the amount the taxpayer treats as compensation or reports as income under paragraph (a)(2)(ii)(C)(1) of this section to the specified individual, plus any amount the specified individual reimburses the taxpayer.

(d) Expenses subject to disallowance under this section --(1) Definition of expenses. In determining the amount of expenses subject to disallowance under this section, a taxpayer must include all of the expenses of operating the aircraft, including all fixed and variable expenses the taxpayer deducts in the taxable year. These expenses include, but are not limited to, salaries for pilots, maintenance personnel, and other personnel assigned to the aircraft; meal and lodging expenses of flight personnel; take-off and landing fees; costs for maintenance flights; costs of on-board refreshments, amenities and gifts; hangar fees (at home or away); management fees; costs of fuel, tires, maintenance, insurance, registration, certificate of title, inspection, and depreciation; interest on debt secured by or properly allocated (within the meaning of § 1.163-8T) to an aircraft; and all costs paid or incurred for aircraft leased or chartered to the taxpayer.

(2) Leases or charters to third parties. Expenses allocable to a lease or charter of a taxpayer's aircraft to an unrelated (as determined under section 267(b) or 707(b)) third-party in a bona-fide business transaction for adequate and full consideration are excluded from the definition of expenses in paragraph (d)(1) of this section. Only expenses allocable to the lease or charter period are excluded under this paragraph (d)(2).



(3) Straight-line method permitted for determining depreciation disallowance under this section --(i) In general. In lieu of the amount of depreciation deducted in the taxable year, solely for purposes of paragraph (d)(1) of this section, a taxpayer may elect to treat as its depreciation deduction the amount that would result from using the straight-line method of depreciation over the class life (as defined by section 168(i)(1) and using the applicable convention under section 168(d)) of an aircraft, even if the taxpayer uses a different methodology to calculate depreciation for the aircraft under other sections of the Internal Revenue Code (for example, section 168). If the property qualifies for the additional first-year depreciation deduction provided by, for example, section 168(k), 168(n), 1400L(b), or 1400N(d), depreciation for purposes of this straight-line election is determined on the unadjusted depreciable basis (as defined in § 1.168(b)-1(a)(3)) of the property. However, the amount of depreciation disallowed as a result of this paragraph (d)(3) for any taxable year cannot exceed a taxpayer's allowable depreciation for that taxable year. For purposes of this section, a taxpayer that elects to use the straight-line method and class life under this paragraph (d)(3) for any aircraft it operates must use that methodology for all depreciable aircraft it operates and must continue to use the methodology for the entire period the taxpayer uses any depreciable aircraft.

(ii) Aircraft placed in service in earlier taxable years. The amount of depreciation for purposes of this paragraph (d)(3) for aircraft placed in service in taxable years before the taxable year of the election is determined by applying the straight-line method of depreciation to the unadjusted depreciable basis (or, for property acquired in an exchange to which section 1031 applies, the basis of the aircraft as determined under section 1031(d)) and over the class life (using the applicable convention under section 168(d)) of the aircraft as though the taxpayer used that methodology from the year the aircraft was placed in service.

(iii) Manner of making and revoking election. A taxpayer makes the election under this paragraph (d)(3) by filing an income tax return for the taxable year that determines the taxpayer's expenses for purposes of paragraph (d)(1) of this section by computing depreciation under this paragraph (d)(3). A taxpayer may revoke an election only for compelling circumstances upon consent of the Commissioner by private letter ruling.

(4) Aggregation of aircraft --(i) In general. A taxpayer may aggregate the expenses of aircraft of similar cost profiles for purposes of calculating disallowed expenses under paragraph (c) of this section.

(ii) Similar cost profiles. Aircraft are of similar cost profiles if their operating costs per mile or per hour of flight are comparable. Aircraft must have the same engine type (jet or propeller) and the same number of engines to have similar cost profiles. Other factors to be considered in determining whether aircraft have similar cost profiles include, but are not limited to, maximum take-off weight, payload, passenger capacity, fuel consumption rate, age, maintenance costs, and depreciable basis.

(5) Authority for establishing safe harbors for determining expenses. The Commissioner may establish in published guidance, see § 601.601(d)(2) of this chapter, one or more safe harbor methods under which a taxpayer may determine the amount of expenses paid or incurred for entertainment flights.

(e) Allocation of expenses -- (1) General rule. For purposes of determining the expenses allocated to entertainment air travel of a specified individual under paragraph (a)(2)(ii)(C) of this section, a taxpayer must use either the occupied seat hours or miles method of paragraph (e)(2) of this section or the flight-by-flight method of paragraph (e)(3) of this section. A taxpayer must use the chosen method for all flights of all aircraft for the taxable year.

(2) Occupied seat hours or miles method -- (i) In general. The occupied seat hours or miles method determines the amount of expenses allocated to a particular entertainment flight of a specified individual based on the occupied seat hours or miles for an aircraft for the taxable year. Under this method, a taxpayer may choose to use either occupied seat hours or miles for the taxable year to determine the amount of expenses allocated to entertainment flights of specified individuals, but must use occupied seat hours or miles consistently for all flights of all aircraft for the taxable year.

(ii) Computation under the occupied seat hours or miles method. The amount of expenses allocated to an entertainment flight taken by a specified individual is computed under the occupied seat hours or miles method by determining--

(A) The total expenses for the year under paragraph (d) of this section for the aircraft or group of aircraft (if aggregated under paragraph (d)(4) of this section), as applicable;

(B) The number of occupied seat hours or miles for the taxable year for the aircraft or group of aircraft by totaling the occupied seat hours or miles of all flights in the taxable year flown by the aircraft or group of aircraft, as applicable. The occupied seat hours or miles for a flight is the number of hours or miles flown for the flight multiplied by the number of seats occupied on that flight. For example, a flight of 6 hours with three passengers results in 18 occupied seat hours;

(C) The cost per occupied seat hour or mile for the aircraft or group of aircraft, as applicable, by dividing the total expenses under paragraph (e)(2)(ii)(A) of this section by the total number of occupied seat hours or miles under paragraph (e)(2)(ii)(B) of this section; and

(D) The amount of expenses allocated to an entertainment flight taken by a specified individual by multiplying the number of hours or miles of the flight by the cost per occupied hour or mile for that aircraft or group of aircraft, as applicable, as determined under paragraph (e)(2)(ii)(C) of this section.

(iii) Allocation of expenses of multi-leg trips involving both business and entertainment legs. A taxpayer that uses the occupied seat hours or miles allocation method must allocate the expenses of a trip by a specified individual that involves at least one segment for business and one segment for entertainment between the business travel and the entertainment travel unless none of the expenses for the entertainment segment are disallowed. The entertainment cost of a multi-leg trip is the total cost of the flights (by occupied seat hours or miles) minus the cost of the flights that would have been taken without the entertainment segment or segments.

(iv) Examples. The following examples illustrate the provisions of this paragraph (e)(2):

Example 1.

(i) A taxpayer-provided aircraft is used for Flights 1, 2, and 3, of 5 hours, 5 hours, and 4 hours, respectively, during the Taxpayer's taxable year. Each flight carries four passengers. On Flight 1, none of the passengers is a specified individual. On Flight 2, passengers A and B are specified individuals traveling for entertainment purposes and passengers C and D are not specified individuals. For Flight 2, Taxpayer treats \$ 1,200 as compensation to A, and B reimburses Taxpayer \$ 500. On Flight 3, all four passengers (A, B, E, and F) are specified individuals traveling for entertainment purposes. For Flight 3, Taxpayer treats \$ 1,300 each as compensation to A, B, E, and F. Taxpayer incurs \$ 56,000 in expenses for the operation of the aircraft for the taxable year. The aircraft is operated for 56 occupied seat hours for the period (four passengers times 5 hours (20 occupied seat hours) for Flight 1, plus four passengers times 5 hours (20 occupied seat hours) for Flight 2, plus four passengers times 4 hours (16 occupied seat hours) for Flight 3. The cost per occupied seat hour is \$ 1,000 (\$ 56,000/56 hours).

(ii) For purposes of determining the amount disallowed (to the extent not treated as compensation or reimbursed) for entertainment provided to specified individuals, \$ 5,000 (\$ 1,000 x 5 hours) each is allocable to A and B for Flight 2, and \$ 4,000 (\$ 1,000 x 4 hours) each is allocable to A, B, E, and F for Flight 3.

(iii) For Flight 2, because Taxpayer treats \$ 1,200 as compensation to A, and B reimburses Taxpayer \$ 500, Taxpayer may deduct \$ 1,700 of the cost of Flight 2 allocable to A and B. The deduction for the remaining \$ 8,300 cost allocable to entertainment provided to A and B on Flight 2 is disallowed (for A, \$ 5,000 less the \$ 1,200 treated as compensation, and for B, \$ 5,000 less the \$ 500 reimbursed).

(iv) For Flight 3, because Taxpayer treats \$ 1,300 each as compensation to A, B, E, and F, Taxpayer may deduct \$ 5,200 of the cost of Flight 3. The deduction for the remaining \$ 10,800 cost allocable to entertainment provided to A, B, E, and F on Flight 3 is disallowed (\$ 4,000 less the \$ 1,300 treated as compensation to each specified individual).

#### Example 2.

(i) G, a specified individual, is the sole passenger on an aircraft that makes three flights. First, G travels on a two-hour flight from City A to City B for business purposes. G then travels on a three-hour flight from City B to City C for entertainment purposes, and returns from City C to City A on a four-hour flight. G's flights have resulted in nine occupied seat hours (two for the first segment, plus three for the second segment, plus four for the third segment). If G had returned directly to City A from City B, the flights would have resulted in four occupied seat hours.

(ii) Under paragraph (e)(2)(iii) of this section, five occupied seat hours are allocable to G's entertainment (nine total occupied seat hours minus the four occupied seat hours that would have resulted if the travel had been a roundtrip business trip without the entertainment segment). If Taxpayer's cost per occupied seat hour for the year is \$ 1,000, \$ 5,000 is allocated to G's entertainment use of the aircraft (\$ 1,000 x five occupied seat hours). The amount disallowed is \$ 5,000 minus the total of any amount the Taxpayer treats as compensation to G plus any amount that G reimburses Taxpayer.

(3) Flight-by-flight method -- (i) In general. The flight-by-flight method determines the amount of expenses allocated to a particular entertainment flight of a specified individual on a flight-by-flight basis by allocating expenses to individual flights and then to a specified individual traveling for entertainment purposes on that flight.

(ii) Allocation of expenses. A taxpayer using the flight-by-flight method must combine all expenses (as defined in paragraph (d)(1) of this section) for the taxable year for the aircraft or group of aircraft (if aggregated under paragraph (d)(4) of this section), as applicable, and divide the total amount of expenses by the number of flight hours or miles for the taxable year for that aircraft or group of aircraft, as applicable, to determine the cost per hour or mile. Expenses are allocated to each flight by multiplying the number of miles for the flight by the cost per mile or the number of hours for the flight by the cost per hour. The expenses for the flight then are allocated to the passengers on the flight per capita. Thus, if five passengers are traveling on a flight, and the total expense allocated to the flight is \$ 10,000, the expense allocable to each passenger is \$ 2,000.

(f) Special rules -- (1) Determination of basis. (i) If any deduction for depreciation is disallowed under this section, the rules of § 1.274-7 apply. In that case, the basis of an aircraft is not reduced for the amount of depreciation disallowed under this section.

(ii) The provisions of this paragraph (f)(1) are illustrated by the following examples:

Example 1.

(i) B Co. is a calendar-year taxpayer that owns an aircraft not used in commercial or contract carrying of passengers or freight. The aircraft is placed in service on July 1 of Year 1 and has an unadjusted depreciable basis of \$ 1,000,000. The class life of the aircraft for depreciation purposes is 6 years. For determining depreciation under section 168, B Co. uses the optional depreciation table that corresponds with the general depreciation system, the 200 percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. For determining the depreciation disallowance for each year under paragraph (d)(3) of this section, B Co. elects to use the straight-line method of depreciation and the class life of 6 years and, therefore, uses the optional depreciation table for purposes of section 168 that corresponds with the straight-line method of depreciation, a recovery period of 6 years, and the half-year convention. In each year, the aircraft entertainment use subject to disallowance under this section is 10 percent of the total use.

(ii) B Co. calculates the depreciation and basis of the aircraft as follows:

	200 Percent declining balance deprecia- tion amount	Straight line deprecia- tion amount	Depreciati on dis- allowance under section 274	Deprecia- tion deduction	§ 1.274- 7 Basis of aircraft	Suspended basis.
Year 1	200,000	83,300	8,330. (.10 x 83,300)	191,670 (200,000 minus 8,330)	808,330 (1,000,000 minus 191,670)	8,330.
Year 2	320,000	166,700	16,670 (.10 x 166,700)	303,330 (320,000 minus 16,670)	505,000 (808,330 minus 303,330)	25,000 (8,300 plus 16,670).
Year 3	192,000	166,700	16,670 (.10 x 166,700)	175,330 (192,000 minus 16,670)	329,670 (505,000 minus 175,330)	41,670 (25,000 plus 16,670).
Year 4	115,200	166,700	16,670 (.10 x 166,700)	98,530 (115,200 minus 16,670)	231,140 (329,670 minus 98,530)	58,340 (41,670 plus 16,670).
Year 5	115,200	166,600	16,660 (.10 x 166,600)	98,540 (115,200 minus 16,660)	132,600 (231,140 minus 98,540)	75,000 (58,340 plus 16,660).
Year 6	57,600	166,700	16,670 (.10 x 166,700)	40,930 (57,600 minus 16,670)	91,670 (132,600 minus 40,930)	91,670 (75,000 plus 16,670).

	200 Percent declining balance deprecia- tion amount	Straight line deprecia- tion amount	Depreciati on dis- allowance under section 274	Deprecia- tion deduction	§ 1.274- 7 Basis of aircraft	Suspended basis.
Year 7		83,300	8,330 (.10 x 83,300)		91,670	91,670.

(iii) In Year 7, there is no further deduction for depreciation of the aircraft, therefore, under paragraph (d)(3) of this section, no depreciation expense is disallowed. Under § 1.274-7 and this paragraph (f)(1), basis is not reduced for disallowed depreciation. Therefore, at the end of Year 7, the basis of the aircraft for purposes of § 1.274-7 is \$ 91,670, which is the total amount of disallowed depreciation in Years 1 through 6. B Co.'s deductions for depreciation total \$ 908,330, which added to \$ 91,670 equals \$ 1,000,000.

#### Example 2.

(i) The facts are the same as in Example 1, except that B Co. does not elect to use the straight-line method of depreciation under paragraph (d)(3) of this section until Year 3.

(ii) B Co. calculates the depreciation and basis of the aircraft as follows:

	200 Percent declining balance deprecia- tion amount	Straight line deprecia- tion amount	Depreciati on dis- allowance under section 274	Deprecia- tion deduction	§ 1.274 Basis of aircraft	Suspended basis.
Year 1	200,000		20,000 (.10 x 200,000)	180,000	820,000 (1,000,000 minus 180,000)	20,000.
Year 2	320,000		32,000 (.10 x 320,000)	288,000 (320,000 minus 32,000)	532,000 (820,000 minus 288,000)	52,000 (20,000 plus 32,000).
Year 3	192,000	166,700	16,670 (.10 x 166,700)	175,330 (192,000 minus 16,670)	356,670 (532,000 minus 175,330)	68,670 (52,000 plus 16,670).
Year 4	115,200	166,700	16,670 (.10 x 166,700)	98,530 (115,200 minus 16,670)	258,140 (356,670 minus 98,530)	85,340 (68,670 plus 16,670).
Year 5	115,200	166,600	16,660 (.10 x 166,600)	98,540 (115,200 minus 16,660)	159,600 (258,140 minus 98,540)	102,000 (85,340 plus 16,660).

	200 Percent declining balance deprecia- tion amount	Straight line deprecia- tion amount	Depreciati on dis- allowance under section 274	Deprecia- tion deduction	§ 1.274 Basis of aircraft	Suspended basis.
Year 6	57,600	166,700	16,670 (.10 x 166,700)	16,660) 40,930 (57,600 minus 16,670)	98,540) 118,670 (159,600 minus 40,930)	16,660). 118,670 (102,000 plus 16,670).
Year 7		83,300	8,330 (.10 x 83,300)	0	118,670	118,670.

(iii) In Year 7, there is no further deduction for depreciation of the aircraft, therefore, under paragraph (d)(3) of this section, no depreciation expense is disallowed. Under § 1.274-7 and this paragraph (f)(1), basis is not reduced for disallowed depreciation. Therefore, at the end of Year 7, the basis of the aircraft for purposes of § 1.274-7 is \$ 118,670, which is the total amount of disallowed depreciation in Years 1 through 6. B Co.'s deductions for depreciation total \$ 881,330, which added to \$ 118,670 equals \$ 1,000,000.

(2) Pro rata disallowance. (i) The amount of disallowed expenses, and any amounts reimbursed or treated as compensation, under this section are applied on a pro rata basis to all of the categories of expenses subject to disallowance under this section.

(ii) The provisions of this paragraph (f)(2) are illustrated by the following example:

Example.

(i) C Co. owns an aircraft that it uses for business and other purposes. The expenses of operating the aircraft in the current year total \$ 1,000,000. This amount includes \$ 250,000 for depreciation (25 percent of total expenses).

(ii) In the same year, the aircraft entertainment use subject to disallowance under this section is 20 percent of the total use and C Co. treats \$ 80,000 as compensation to specified individuals. Thus, the amount of the disallowance under this section is \$ 120,000 (\$ 1,000,000 x 20 percent (\$ 200,000) less \$ 80,000).

(iii) Under paragraph (f)(2) of this section, C Co. may calculate the amount by which a category of expense, such as depreciation, is disallowed by multiplying the total disallowance of \$ 120,000 by the ratio of the amount of the expense to total expenses. Thus, \$ 30,000 of the \$ 120,000 total disallowed expenses is depreciation (\$ 250,000/\$ 1,000,000 (25 percent) x \$ 120,000).

(iv) The result is the same if C Co. separately calculates the amount of depreciation in total disallowed expenses and in the amount treated as compensation and nets the result. Depreciation is 25 percent of total expenses, thus, the amount of depreciation in disallowed expenses is \$ 50,000 (25 percent x \$ 200,000 total disallowed expenses) and the amount of depreciation treated as compensation is \$ 20,000 (25 percent x \$ 80,000). Disallowed depreciation is \$ 50,000 less \$ 20,000, or \$ 30,000.



(3) Deadhead flights. (i) For purposes of this section, an aircraft returning without passengers after discharging passengers or flying without passengers to pick up passengers (deadheading) is treated as having the same number and character of passengers as the leg of the trip on which passengers are aboard for purposes of allocating expenses under paragraphs (e)(2) or (e)(3) of this section. For example, when an aircraft travels from point A to point B and then back to point A, and one of the legs is a deadhead flight, for determination of disallowed expenses, the aircraft is treated as having made both legs of the trip with the same passengers aboard for the same purposes.

(ii) When a deadhead flight does not occur within a roundtrip flight, but occurs between two unrelated flights involving more than two destinations (such as an occupied flight from point A to point B, followed by a deadhead flight from point B to point C, and then an occupied flight from point C to point A), the allocation of passengers and expenses to the deadhead flight occurring between the two occupied trips must be based solely on the number of passengers on board for the two occupied legs of the flight, the character of the travel of the passengers on board (entertainment or nonentertainment) and the length in hours or miles of the two occupied legs of the flight.

(iii) The provisions of this paragraph (f)(3) are illustrated by the following examples:

Example 1.

(i) Aircraft flies from City A to City B, a 6-hour trip, with 12 passengers aboard. Eight of the passengers are traveling for business and four of the passengers are specified individuals traveling for entertainment purposes. The aircraft flies empty (deadheads) from City B to City C, a 4-hour trip. At City C it picks up 12 passengers, six of whom are traveling for business and six of whom are specified individuals traveling for entertainment purposes, for a 2-hour trip to City A. The taxpayer uses the occupied seat hour method of allocating expenses.

(ii) The two legs of the trip on which the aircraft is occupied comprise 96 occupied seat hours (12 passengers x 6 hours (72) for the first leg plus 12 passengers x 2 hours (24) for the third leg). Sixty occupied seat hours are for business (8 passengers x 6 hours (48) for the first leg plus 6 passengers x 2 (12) hours for the third leg) and 36 occupied seat hours are for entertainment purposes (4 passengers x 6 hours (24) for the first leg plus 6 passengers x 2 (12) hours for the third leg). Dividing the 36 occupied seat entertainment hours by 96 total occupied seat hours, 37.5 percent of the total occupied seat hours of the two occupied flights are for entertainment.

(iii) The 4-hour deadhead leg comprises one-third of the total flight time of 12 hours. Therefore, the deadhead flight is deemed to have provided one-third of the total 96 occupied seat hours, or 32 occupied seat hours ( $96 \times 1/3 = 32$ ). Of the 32 deemed occupied seat hours, 37.5 percent, or 12 deemed occupied seat hours, are treated as entertainment under paragraph (f)(3)(ii) of this section. The 32 deemed occupied seat hours for the deadhead flight are included in the calculation under paragraph (e)(2)(ii)(B) of this section and expenses are allocated under paragraph (e)(2)(ii)(D) of this section to the 12 deemed occupied seat hours treated as entertainment.

Example 2.

(i) The facts are the same as for Example 1, but the taxpayer uses the flight-by-flight method of allocation.

(ii) Of the 24 passengers on the occupied flights, 10 passengers, or 41.7 percent, are traveling for entertainment purposes. If the annual cost per flight hour calculated under

paragraph (e)(3)(ii) of this section is \$ 1,000, \$ 4,000 is allocated to the 4-hour deadhead leg. Under paragraph (f)(3)(ii) of this section, 41.7 percent of the \$ 4,000, or \$ 1,667, is treated as an expense for entertainment. The calculation of the cost per mile or hour for the year under paragraph (e)(3)(ii) of this section includes the expenses and number of miles or hours flown for the deadhead leg.

(g) Effective/applicability date. This section applies to taxable years beginning after August 1, 2012.