

# **4<sup>th</sup> Annual Executive Compensation Conference**

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## **The Art and Science of Perquisites**

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# The first challenge is finding them. They are all over the place:

Car Allowance  
Car Insurance  
Chauffeured Limousines  
Club Dues  
Club Initiation Fee  
Commission for Sale of Home  
Commuting Expense  
Computer Equipment  
Corporate Residence  
Costs Associated with Expatriate Work Assignment  
Currency Exchange Arrangements  
Discounts on Company's Products  
Excess Liability Insurance  
Executive Office Benefits  
Financial Consulting Services  
Gas Allowance  
Goods and Services Differential (for Foreign Service)  
Home Office Costs  
Home Security  
Housing Allowance  
Legal Expenses  
Life Insurance Premiums  
Living Expense Reimbursements  
Long Term Disability Insurance  
Medical and Dental Claims/Premiums

Parking Fees  
Personal Liability Insurance  
Personal Travel on Corporate Aircraft  
Personal Use of Company Housing  
Home Office Costs  
Home Security  
Housing Allowance  
Legal Expenses  
Life Insurance Premiums  
Living Expense Reimbursements  
Long Term Disability Insurance  
Medical and Dental Claims/Premiums  
Parking Fees  
Personal Liability Insurance  
Personal Travel on Corporate Aircraft  
Personal Use of Company Housing  
Personal Use of Company-Provided Admin. Support  
Physical Exam/Voluntary Health Screening  
Private Securities (bodyguards)  
Relocation Expenses  
School Tuition  
Secured Parking  
Security Concerning Fraudulent Data Access  
Spouse's Travel Expenses  
Stipend for Effective Company Representation in the Community  
Wireless Network for Computer Use  
Supplemental Accidental Death and Dismemberment Insurance  
Tax Equalization Payments (for foreign service)  
Tax Gross Ups (not always perquisite)  
Telephone Services

Trips Awarded to Top Sales Performers  
Use of Corporate Travel Agency for Personal Travel  
Use of Executive Dining Room  
Wellness Reimbursement (for fitness related activities)

## A Few Others ...

Beer for personal use

Complimentary Use of Hotel Rooms

Executive's Family Travel Expenses

Gardening and Cleaning Services

Unlimited Theme Park Tickets

Use of Company Barber Shop

Vehicle "Evaluation" Program

"Perquisite Allowance"

You need to develop a set of steps to identify perquisites:

- Check with HR
- Check with key administrative staff
- Review appropriate GL accounts
- Review employment agreements
- Confirm with executives through D&O questionnaires or otherwise
- Etc.

Technically, key is whether the item is “integrally and directly related to the performance of the executive’s duties.” If not, it is a perquisite.

The second challenge is identifying incremental cost. The rules provide little guidance.

- Common sense should control.
- Tax rules do not control.
- What counts is your cost, not someone else's cost.
- At \$10,000, in the aggregate, perquisites must be included and "identified."
- At greater of \$25,000 or 10% of amount included, must be quantified.
- Must describe "methodology" if quantified.

## Airplanes generate special problems:

- Some costs legitimately are fixed – e.g., insurance and hanger
- Some costs are minimal – the depreciation allocable to an individual flight
- Some costs are obvious – fuel and landing fees
- The rest lie in a gray area – particularly heavy maintenance

Good Citizen

Bad Citizen

Fuel	Yes	Yes
Catering	Yes	No (“insignificant”)
Landing fees	Yes	Yes
Heavy maintenance	Yes	No (“close to fixed”)
Dead head time	Yes	No (“positioning”)

## Flight from Cincinnati to the Beach

Good Citizen: 8 hours @ \$4,000/hour = \$32,000

Bad Citizen: 4 hours @ \$2,100/hour = \$8,400

Good Citizen gets slammed in  
his proxy statement!



## Hourly Lease Comparables (As of 8/1/07)

<u>Category</u>	<u>Aircraft Type</u>	<u>Round Trip (Rate Per Hour)</u>	<u>One Way (Rate Per Hour)</u>
Light	Lear 35A	\$ 2,600	\$ 3,740
Light	Beechjet 400A	\$ 3,445	\$ 4,150
Mid	Gulfstream G150	\$ 4,190	\$ 5,995
Super Mid	Citation X	\$ 5,140	\$ 7,635
Super Mid	Gulfstream G200	\$ 5,355	\$ 8,046
Heavy	Falcon 900B	\$ 6,840	\$ 9,480

## Good Disclosure Examples

Determined using a method that takes into account: landing fees, parking and flight planning expenses; crew travel expenses; supplies and catering; aircraft fuel and oil expenses; maintenance, parts and external labor (inspections and repairs); engine insurance expenses; foreign permits and customs expenses; positioning flight costs; and passenger ground transportation. Since our aircraft are used primarily for business travel, we do not include the fixed costs that do not change based on usage, such as crew salaries and the acquisition costs of Corporation-owned or leased aircraft.

Bank of America

March 19, 2007

In determining the incremental cost to the Company of the personal use of Company aircraft, the Company calculates, for each aircraft, the direct variable operating cost on an hourly basis, including all costs that may vary by the hours flown. Items included in calculating this cost are: aircraft fuel and oil; travel, lodging and other expenses for crew; prorated amount of repairs and maintenance; prorated amount of rental fee on airplane hangar; catering; logistics (landing fees, permits, etc.); telecommunication expenses and other supplies; and the amount, if any, of disallowed tax deductions associated with such use. When the aircraft are already flying to a destination for business purposes, only the direct variable costs associated with the additional passenger (for example, catering) are included in determining the aggregate incremental cost of the use to the Company.

The Coca-Cola Company  
April 18, 2007

The incremental cost of Kellogg aircraft used for a non-business flight is calculated by multiplying the aircraft's hourly variable operating cost by a trip's flight time, which includes any flight time of an empty return flight. Variable operating costs include: (1) landing, parking, crew travel and flight planning services expenses; (2) supplies, catering and crew traveling expenses; (3) aircraft fuel and oil expenses; (4) maintenance, parts and external labor (inspections and repairs); and (5) any customs, foreign permit and similar fees. Fixed costs that do not vary based upon usage are not included in the calculation of direct operating cost. On certain occasions, an NEO's spouse or other family member may accompany the NEO on a flight. No additional direct operating cost is incurred in such situations under the foregoing methodology because the costs would not be incremental.

Kellogg's  
March 19, 2007

Employees' access to business equipment, transportation, temporary accommodation, or other support services is allocated based on appropriate business purposes and not as a form of informal compensation. The company provides air and other travel for Intel's executive officers for business purposes only. Intel's company-owned aircraft hold approximately 40 passengers and are used in regularly scheduled shuttle routes between Intel's major U.S. facility locations, and Intel's use of noncommercial aircraft on a time-share or rental basis is limited to appropriate business-only travel.

Intel Corporation  
March 27, 2007

## Great Disclosure

Would clearly address:

- Semi-variable costs (e.g., maintenance)
- Disallowance of deductions
- Dead head time
- Free loaders

Could (but not required) address:

- Hourly rate
- Hours used (or trips)

Incremental cost for corporate aircraft includes, calculated on a per hour basis for each aircraft, (1) fuel, oil and catering, (2) travel, lodging and other crew expenses, (3) landing, parking, flight planning, customs and similar fees, (4) maintenance (including inspections and overhauls), parts and external labor, and (5) the amount, if any, of disallowed tax deductions, and (6) similar costs. Since our aircraft are used over 95% for business travel, incremental costs exclude fixed costs such as depreciation, crew compensation, hangar rent, and insurance. Any applicable deadhead and other positioning costs are allocated to the executives. Where spouses or other guests accompany an executive on a flight, applicable catering costs are allocated to the executive as well. In 2007 Mr. Able used corporate aircraft for personal use for an aggregate of 37 hours at an average incremental cost of \$4,950 per hour, and Mr. Baker used corporate aircraft for personal use for an aggregate of 26 hours at an average incremental cost of \$3,800 per hour.

Good Citizen  
April 3, 2008

## Remember – Tax issues need to be considered

- IRC §274 calculation of costs is all encompassing
- Company can deduct only what executive includes in income
- Standard Industry Fee Level (SIFL) ≠ incremental cost
- Gross-ups are doubly expensive

Also, watch for Part 91 (2x Fuel Rule)



# Resources

- Survey of 100+ companies
- *Business & Commercial Aviation*
- *Journal of Business Aviation*
- SEC Release 34 – 54302, Part II(C)(1)(e)(i).

“Disclosure controls” apply to perquisites!

Develop a rational, sustainable approach for capturing perquisites and determining their incremental costs

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