



Bonus Depreciation Update

Relevant IRC sections and their impact on Bonus Depreciation
AND

Tax Cuts and Jobs Act of 2017

Update on TCJA provisions impacting business aviation

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Bonus Depreciation Update

Code Sections Impacting Depreciation Write-Off

- ▶ IRC 162
- ▶ IRC 183
- ▶ IRC 212
- ▶ IRC 280F
- ▶ IRC 274
- ▶ IRC 469
- ▶ IRC 461 (I)

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IRC 162 – Trade or Business Expenses

- ▶ Threshold section to determine deductibility.
- ▶ Expenses must be ordinary, necessary, and reasonable.

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IRC 183 – Activities Not Engaged in For Profit

- ▶ “Hobby losses” are disallowed to extent they exceed gross income from the hobby activity.
- ▶ Presumption that activity is engaged in for profit if the gross income derived exceeds the deductions attributable to such activity for 3 or more years in a 5 consecutive year period.
- ▶ Common IRS audit position.

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IRC 212 – Expenses for Production of Income

- ▶ Old law: Expenses for production of income (investments) deductible.
- ▶ New law: Non-deductible.

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IRC 280F

- ▶ Must be eligible for MACRS to get Bonus Depreciation.
 - *Discussed in detail later on in presentation*

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IRC 274 – Commuting/Entertaining Disallowance

- ▶ Old law: Deductions for personal entertainment use disallowed.
- ▶ New law: Deductions for entertainment use, business entertainment use, and commuting disallowed.
- ▶ Focus on year that aircraft is acquired.

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IRC 469 – Passive Activity

- ▶ Activity in which the taxpayer does not materially participate.
- ▶ Rental activity is per se passive activity, regardless of material participation, subject to certain exceptions.
- ▶ Passive losses can only offset passive income in a given tax year.
 - Excess losses carried forward until disposition of entire interest in the passive activity.

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IRC 461(I) – Limitation on Excess Business Loss

- ▶ Excess business loss is disallowed and carried forward as a net operating loss in the following taxable year.
- ▶ Excess business loss is:
 - The aggregate deductions of the taxpayer attributable to trades or businesses of such taxpayer, over
 - The aggregate gross income attributable to such trades of businesses + \$250,000 or \$500,000 (if joint return)
- ▶ Therefore, even if can get 100% bonus depreciation, may not be able to use all of it in the year of acquisition.
- ▶ Net operating loss carry forwards are subject to 80% limitation rule.

Bonus Depreciation Update

- ▶ “**Bonus Depreciation**” allows immediate depreciation/expensing of all or a portion of a taxpayer’s basis in certain “**Qualified Property**” in the year that such property is placed in service.
- ▶ The portion of the taxpayer’s basis that may be expensed in the year that such property is placed in service depends on the year that such property is placed in service.

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Bonus Depreciation by Placed in Service Year

- ▶ 100% for Qualified Property placed in service after September 27, 2017 (*provided that a “Written Binding Contract” was not in place on or before September 27, 2017*), and before January 1, 2023;
- ▶ 80% for Qualified Property placed in service after December 31, 2022, and before January 1, 2014;
- ▶ 60% for Qualified Property placed in service after December 31, 2023, and before January 1, 2025;

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Bonus Depreciation by Placed in Service Year (cont'd)

- ▶ 40% for Qualified Property placed in service after December 31, 2024, and before January 1, 2026;
- ▶ 20% for Qualified Property placed in service after December 31, 2025, and before January 1, 2027; and
- ▶ 0% for Qualified Property placed in service after December 31, 2026.

The above placed in service deadlines are all extended by an additional year for “Certain Aircraft” and “Property Having Long Production Times.”

Bonus Depreciation Update

Application of “Written Binding Contract” Rule to OEM Contacts

- ▶ In the context of an OEM contract to build an aircraft, under newly adopted regulations, the aircraft is treated as self-constructed property rather than as property acquired pursuant to a Written Binding Contract. Consequently, the fact that the OEM contract may have been signed prior to September 27, 2017 does not automatically disqualify the aircraft from 100% bonus depreciation. For purposes of determining eligibility for Bonus Depreciation, such self-constructed property will be treated as having been acquired on the later of:
 - the date on which the contract is entered into;
 - the date on which the contract is enforceable under state law;
 - if the contract has one or more cancellation periods, the date on which all cancellation periods end; or
 - if the contract has one or more contingency clauses, the date on which all conditions subject to such clauses are satisfied

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- ▶ Used Aircraft Must Meet an Acquisition Requirement
- ▶ The Acquisition Requirement is met if:
 1. The property was not used by the taxpayer or an affiliate at any time prior to such acquisition. Final regulations treat property as used by the taxpayer or a predecessor before acquisition by the taxpayer if the taxpayer or the predecessor had a depreciable interest in the property at any time before such acquisition, whether or not the taxpayer or the predecessor claimed depreciation deductions for the property.
 2. The acquisition of such property meets the requirements of paragraphs (2)(A), (2)(B), (2)(C), and (3) of IRC Section 179(d).

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Qualified Property: Exclusion of Alternative Depreciation System Property (1 of 5)

- ▶ Notwithstanding the previous slides, the term “Qualified Property” does not include any property to which the alternative depreciation system (“ADS”) under IRC 168(g) applies.

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Qualified Property: Exclusion of Alternative Depreciation System Property (2 of 5)

- ▶ Depreciable property may be required to be depreciated under ADS for several reasons, including:
 - Aircraft Not Used Predominantly (i.e., more than 50% of the time) for Qualified Business Uses (“QBU”);
 - 25% QBU Test
 - 50% QBU Test
 - Leasing Company Trap
 - Aircraft Used Predominantly Outside the United States.

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Qualified Property: Exclusion of Alternative Depreciation System Property (3 of 5)

- ▶ IRC Section 280F – Qualified Business Use (QBU)
 - 50% Test
 - In order to depreciate a business aircraft under MACRS, more than 50% of the use of the aircraft must be Qualified Business Use.
 - Qualified Business Use is defined as use in a trade or business of the taxpayer.
 - If 50% QBU failed in subsequent years, must recapture excess depreciation by reference to applicable straight-line schedule.

Bonus Depreciation Update

Qualified Property: Exclusion of Alternative Depreciation System Property (4 of 5)

▶ IRC Section 280F – Qualified Business Use (QBU)

- 25% Test
 - Three types of uses may be treated as QBU for purposes of the 50% test only if all other use excluding such three types of uses accounts for at least 25% of the total use of the aircraft.
 - The three types of uses excluded for purposes of the 25% test are:
 - The leasing of the aircraft to any person who owns 5% or more of the taxpayer, or to any related person (within the meaning of Section 267(b) of the IRC).
 - Use of the aircraft to provide compensation (i.e., to provide personal, non business-use flights without reimbursement at fair market rates) to any person who owns 5% or more of the company, or to any related person (e.g., a flight for which income is imputed to a 5% owner under SIFL).
 - Use of the aircraft to provide compensation to any other person unless an amount is included in the gross income of such person with respect to such use of the aircraft, and any required income tax was withheld (e.g., SIFL).

Bonus Depreciation Update

Qualified Property: Exclusion of Alternative Depreciation System Property (5 of 5)

► IRC Section 280F – Qualified Business Use (QBU)

- CAUTION: Leasing Company Trap!
- TAM 200945037: IRS interpreted 280F to exclude all use of an aircraft that is leased to a related person from being used to meet the 25% test regardless of whether such use was for business or personal purposes.
 - A common example would be the use of a “self-leasing” structure, for sales and use tax purposes, where the lease is respected for federal income tax purposes.

2017 Tax Cuts and Jobs Act Update

Overview

- ▶ Bonus Depreciation
- ▶ Section 179 expensing
- ▶ Restrictions on deductibility of entertainment and commuting expenses
- ▶ Applicability of federal excise taxes to managed aircraft
- ▶ Applicability of Section 1031 like-kind exchanges
- ▶ Disallowance of miscellaneous itemized deductions for individual taxpayers
- ▶ Limits on deductibility of business interest
- ▶ Changes to net operating loss provisions
- ▶ Excess business losses for non-corporate taxpayers

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Section 179 Expensing

- ▶ TCJA increased the amount of the cost of **Section 179** property that may be expensed instead of capitalized from \$500,000 to \$1,000,000.
- ▶ TCJA also increased the limit of the amount of **Section 179** property that may be placed in service before triggering a reduction if the amount that may be expensed from \$2,000,000 to \$2,500,000.
- ▶ **Section 179** property includes depreciable tangible property, certain computer software, and certain improvements to non-residential real property.

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Restriction on Deductibility of Commuting Expenses

- ▶ TCJA provides that “no deduction that be allowed . . . for any expense incurred for providing any transportation, or any payment or reimbursement, to an employee of a taxpayer in connection with travel between the employee’s residence and place of employment, except as necessary to ensure the safety of the employee.”
- ▶ Previously, such expenses were deductible to the company if income was imputed to the employee (i.e., SIFL).

2017 Tax Cuts and Jobs Act Update

Applicability of Federal Excise Taxes to Managed Aircraft

- ▶ TCJA provides that amounts paid by aircraft owners for management services, maintenance and support of the owner's aircraft, and flights on the owner's aircraft, are not subject to the federal excise taxes (FET) imposed by IRC Sections 4261 and 4271.
- ▶ Management services include:
 - Administrative and support services (e.g., scheduling, flight planning, weather forecasting)
 - Obtaining insurance
 - Maintenance, storage and fueling of aircraft
 - Hiring, training and provision of pilots and crew
 - Other services as are necessary to support flights operating by an aircraft owner
- ▶ TCJA further provides that for purposes of the exemption from FET taxes, the term "aircraft owner" includes a lessee of an aircraft other than a disqualified lease.
 - A disqualified lease is a lease from a person (or a related person) who provides management services with respect to the leased aircraft.

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Applicability of Section 1031 Like-Kind Exchanges

- ▶ **IRC Section 1031** permits taxpayers to defer recognition of all or part of the gain on the sale of certain assets if the sale is structured as an exchange of the asset for another asset of like-kind.
- ▶ Prior to TCJA, aircraft owners frequently avoided recognition of recapture gain on the sale of an aircraft by structuring the transaction as an “exchange” for another aircraft.
- ▶ TCJA amended **IRC Section 1031** to limit its applicability to real property, thus eliminating the ability of taxpayers to structure transactions involving aircraft (or any other personal property) as exchanges under **Section 1031**.
- ▶ The impact of the loss of the ability to structure aircraft transactions as **Section 1031** like-kind exchanges is largely mitigated by the inclusion of 100% bonus depreciation in TCJA. However, 100% bonus depreciation is temporary, so the impact of the loss of **Section 1031** for aircraft may be felt if bonus depreciation is phased out as currently required under TCJA.

2017 Tax Cuts and Jobs Act Update

Disallowance of Miscellaneous Itemized Deductions for Individual Taxpayers

- ▶ TCJA suspended the ability to deduct **miscellaneous itemized expenses**.
 - Affects only individuals who itemize their deductions
 - IRC Section 67 allows individuals to deduct that portion of certain miscellaneous expenses that exceeds 2% of their adjusted gross income
 - Miscellaneous itemized expenses include:
 - Unreimbursed business expenses (e.g., unreimbursed expenses for use by an employee of his/her own aircraft for the employer's business)
 - Expenses for the production of income (e.g., IRS Section 212 expenses)
 - Hobby expenses (i.e., IRS Section 183 expenses)
 - TCJA suspends the Section 67 deduction for tax years 2018 through 2025

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Limits on Deductibility of Business Interest

- ▶ TCJA limits a taxpayer's deduction for business interest paid in a tax year to an amount not to exceed the sum of:
 - the taxpayer's business interest income for such tax year; plus
 - 30% of the taxpayer's adjusted taxable income for such tax year; plus
 - Any floor plan financing interest paid by the taxpayer for such tax year.
- ▶ Business interest in excess of the amount permitted to be deducted, based on the foregoing formula, will be carried forward to the following year.
- ▶ Small businesses which meet the gross receipts test of **IRC 448(c)** are exempt from this TCJA limitation
- ▶ **IRC 448(c)** provides that a taxpayer meets the gross receipts test if "the average annual gross receipts of such entity for the 3-taxable-year period ending with the taxable year which precedes such taxable year does not exceed \$25,000,000."

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Changes to Net Operating Loss Provisions

- ▶ TCJA eliminates the ability to carry net operating losses (NOL) back two years
- ▶ TCJA extends the ability to carry NOLs forward indefinitely
 - Formerly NOLs could only be carried forward 20 years

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Excess Business Losses for Non-Corporate Taxpayers

- ▶ Prior to the TCJA, individuals could use NOLs from one business to offset income from other sources (subject to limitations imposed by the “at risk” rules of IRC Section 465 and the “passive loss” rules of IRC Section 469)
- ▶ TCJA temporarily prohibits such taxpayers from deducting their Excess Business Losses (EBL)
- ▶ EBL is the excess of the aggregate deductions of the taxpayer for the taxable year which are attributable to trades or businesses of such taxpayer over the sum of the aggregate gross income or gain from such businesses, plus \$250,000 for a taxpayer filing a single or separate return, or \$500,000 for a taxpayer filing a joint return
- ▶ This limitation applies for tax years 2018 through 2025



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