



BUSINESS AVIATION AND THE BOARDROOM



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Business Aircraft Depreciation Primer

Getting to Grips With The Basics (Part 1 of 2).

Troy Rolf reviews the basics of depreciating a business aircraft in this first of a two-part treatment of a significantly important tax issue.

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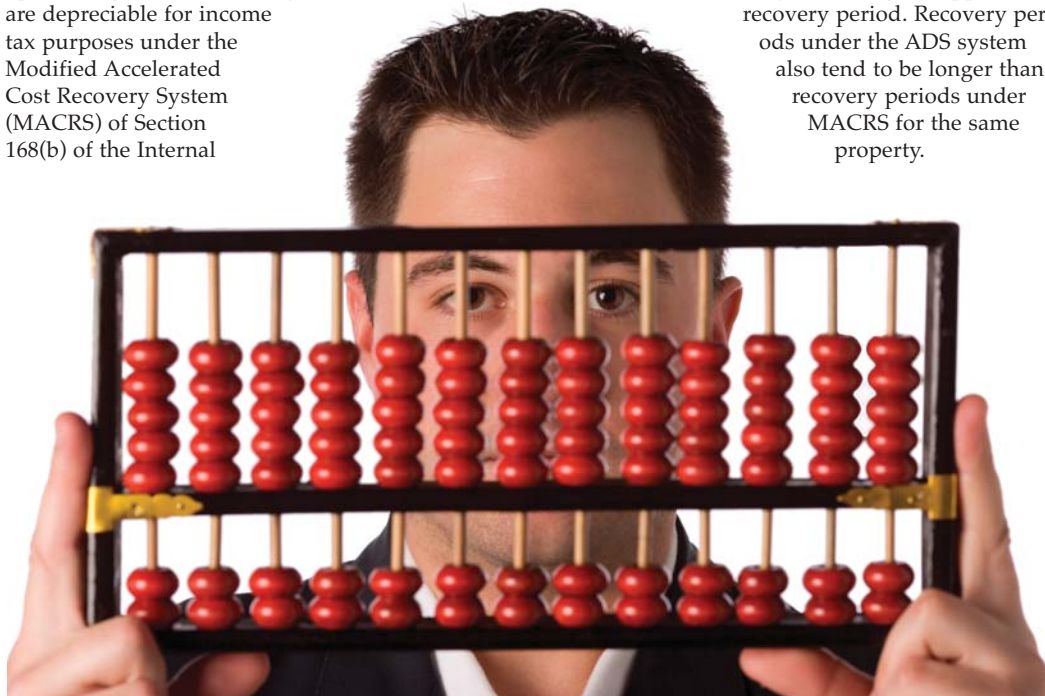
Planning the acquisition of an aircraft should include an analysis of all the state and federal tax issues affecting the acquisition and operations. This month, we provide an overview of tax depreciation as well as a discussion of qualified business uses of business aircraft and the effect of personal, non-business uses on depreciation. Next month we will discuss the effects on depreciation of using a single aircraft for multiple purposes, such as Part 91 business use, Part 135 commercial charter use, and entertainment, recreation and amusement purposes.

OVERVIEW OF TAX DEPRECIATION

Many aircraft owned and operated by businesses today are depreciable for income tax purposes under the Modified Accelerated Cost Recovery System (MACRS) of Section 168(b) of the Internal

Revenue Code. Section 168(b) permits taxpayers to accelerate the depreciation by allowing a greater percentage of the asset's value to be taken during the first few years of the applicable recovery period than would result using a straight-line depreciation method. Of course, the tradeoff is that less depreciation will be available to offset income in later years.

Some aircraft are depreciable for income tax purposes, but do not qualify for accelerated depreciation and must be depreciated under the Alternative Depreciation System (ADS) of Section 168(g) of the Tax Code. Depreciation under ADS is based on a straight-line method and thus results in equal depreciation deductions each year during the applicable recovery period. Recovery periods under the ADS system also tend to be longer than recovery periods under MACRS for the same property. >



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What the Boardroom needs to know about Business Aviation

Whether or not a taxpayer may depreciate an aircraft, and if so, the appropriate depreciation method and recovery period to be used, depends on several factors. Chief among these are the category of aircraft (e.g., airplane or helicopter), and the type of use to which the aircraft is put (personal, business, or commercial charter).

Aircraft, other than helicopters, used in commercial or contract carrying of passengers and freight (typically Part 135 operations) may be depreciated under MACRS over a recovery period of seven years, or under ADS over a recovery period of twelve years. Aircraft used for qualified business purposes or for the production of income (typically industrial-aid use, per Part 91), and helicopters used in commercial or contract carrying of passengers and freight may be depreciated under MACRS over a recovery period of five years, or under ADS over a recovery period of six years.

NON-BUSINESS USE & DEPRECIATION

If an aircraft is used during a taxable year part of the time for a qualified business and/or commercial purpose or for the production of income (collectively "Business Uses"), and part of the time for personal, non-business purposes (collectively "Personal Uses"), the depreciation deduction allowable for the taxable year will be limited to a fraction of the depreciation deduction that would have been allowed had the aircraft been used solely for Business Uses. (As a general rule, a qualified business purpose is any use in a trade or business for which a deduction would be allowed under Section 162 of the Code). The depreciable basis of the aircraft will nevertheless be reduced by the entire amount of depreciation that would have been allowed had all the use of the aircraft during the year constituted Business Use.

In addition, whether the depreciable portion of the aircraft may be depreciated under MACRS, or will be required to be depreciated under ADS, will depend on whether the Business Use or the Personal Use of the aircraft predominates. If more than 50% of the use of the aircraft during each taxable year constitutes Business Use, the depreciable portion of the cost basis of the aircraft generally may be depreciated under MACRS. However, if 50% or less of the use of the aircraft during each taxable year constitutes Business Use, ADS will apply.

The predominant business use test must be met during every taxable year that the aircraft is in service. If the test is failed during any taxable year that the aircraft is in service, the aircraft must be depreciated under the ADS system during such taxable year and all subsequent taxable years. In addition, if the aircraft had been depreciated under MACRS during any prior taxable year, the taxpayer must recapture prior depreciation to the extent that depreciation deductions taken during prior years exceed the deductions that would have been allowed under the ADS system.

We conclude our MACRS overview (Part 1) outlining that the use of a business aircraft falling



within any one of the following three categories will not be treated as a qualified Business Use for depreciation purposes unless all other qualified Business Uses (excluding any use falling within one of the three categories) comprise at least 25% of the total utilization of the aircraft during the applicable taxable year:

1. The leasing of the aircraft by a company to any person who owns 5% or more of the company, or to any person who is related (within the meaning of Section 267(b) of the Internal Revenue Code) to a person who owns 5% or more of the company.
2. 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 person who is related to a person who owns 5% or more of the company.
3. 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., income is imputed under the Standard Industry Fare Level (SIFL) formula).

Note: This article should not be construed as legal advice or legal opinion on any specific facts or circumstances. The reader is urged to consult legal counsel or other advisors concerning his/her own situation and specific legal questions.

Do you have any questions or opinions on the above topic? Get them answered/published in World Aircraft Sales Magazine. Email feedback to: Jack@avbuyer.com
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