

BUSINESS AVIATION AND THE BOARDROOM



Troy A. Rolf, a business aviation and tax attorney, manages the Minnesota office of GKG Law, P.C. Contact him via email at trolf@gkglaw.com.

Business Aircraft Depreciation Primer

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

Troy Rolf concludes his two-part review of the basics of depreciating a business aircraft with a consideration of the possible impact of mixing business use and commercial charter use.

"...the property shall be included in the asset class for the activity in which the property is primarily used."

Many companies that own and operate business aircraft attempt to offset some of their costs by holding the aircraft out for charter at times when it is not otherwise being utilized by the owner. Such mixed utilization of aircraft can affect the depreciation schedule, applicable to the aircraft.

As previously mentioned, aircraft other than helicopters used in commercial or contract carrying of passengers and freight generally may be depreciated under MACRS over a recovery period of seven years, and aircraft used for qualified business purposes or for the production of income and helicopters used in commercial or contract carrying of passengers and freight generally may be depreciated under MACRS over a recovery period of five years.

Consequently, when an aircraft other than a helicopter is used part of the time in commercial or contract carrying of passengers and freight and part of the time for other qualified business purposes or for the production of income, questions concerning the appropriate MACRS

recovery period are likely to arise.

Treasury regulations specify that when property is used for different purposes at various times in such a manner that the property could potentially be classified into more than one asset class, the property shall be included in the asset class for the activity in which the property is primarily used.

Property is to be classified according to the primary use to which the property is put, even though the activity in which the property is used is insubstantial in relation to all of the activities of the taxpayer. In addition, the asset class of an aircraft that is subject to a lease is determined as if the aircraft were owned by the lessee.

Although not further defined in the regulations, the "primarily used" standard appears to suggest that an aircraft (other than a helicopter) will be depreciated under MACRS over a seven year recovery period if the proportion of the time it is used in commercial or contract carrying of passengers and

continued on page 60

Aircraft Index see Page 4



What the Boardroom needs to know about Business Aviation

freight exceeds the proportion of time that it is used for other qualified business purposes or for the production of income. Conversely, the same aircraft will be depreciated under MACRS over a five year recovery period if the proportion of the time it is used for other qualified business purposes or for the production of income exceeds the proportion of time that it is used in commercial or contract carrying of passengers and freight.

For purposes of determining the appropriate asset class for a mixed-use aircraft, it is necessary to determine the primary use of the aircraft during each taxable year that the aircraft is in service. If at any time the primary use of the aircraft changes, it may be necessary to convert from one depreciation schedule to another. This can result in a partial recapture event if, for example, an aircraft is used primarily for business purposes in the first year or so after being placed in service (and is therefore depreciated under MACRS over a five year recovery period), but in later years is used primarily in commercial or contract carrying of passengers and freight (and therefore must be depreciated under MACRS over a seven year recovery period).

EFFECTS OF USE

Depreciation deductions (as well as operating expense deductions) that are otherwise allowable under the rules discussed above, may nevertheless be disallowed to the extent that the deductions are attributable to travel for entertainment, recreation and/or amusement purposes (collectively "Entertainment"). This is a change in the law brought about by the American Jobs Creation Act of 2004 (the "2004 Act"), signed into law by President Bush on October 22, 2004.

Prior to enactment of the 2004 Act, the Eighth Circuit Court of Appeals held in *Sutherland Lumber v. Commissioner of Internal Revenue* that the limitation contained in IRC Section 274(a) (which generally denies deductions for entertainment expenses) did not apply to flights provided by a taxpayer to the taxpayer's shareholders and employees on a company-operated aircraft for recreational purposes if the taxpayer imputed fringe benefit income to the shareholders and employees for the value of flights. Therefore, the company could deduct all the depreciation and operating expenses associated with such flights.

The 2004 Act in effect overruled the *Sutherland Lumber* decision by limiting the deduction permitted to taxpayers for the expenses associated with the provision of Entertainment flights to certain "Specified Individuals" to the amount imputed to the Specified Individuals as fringe benefit income for such flights.

The term "Specified Individuals" includes any person who is the direct or indirect owner of more than 10% of any class of equity security of the taxpayer, and any officer or director of the taxpayer. The 2004 Act does not limit the deduction permitted to companies for the expenses associated with operating flights for entertainment, amusement, or recreational purposes for employees who are not



"Specified Individuals".

Final regulations implementing the 2004 Act went into effect for tax years beginning after August 1, 2012. The final regulations provide two different methods for calculating the disallowance – one highly (some would say overly) complicated, and the other much more simplified. The methods cannot be fully described in this article.

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

Business Aviation and the Boardroom continues on Page 62

"...it is necessary to determine the primary use of the aircraft during each taxable year..."