



Bonus Depreciation Update

Relevant IRC sections and their impact
on Bonus Depreciation

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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.
- ▶ Must meet 50% qualified business use (QBU) – 2 step test:
 - Need over 25% business use, excluding certain specified uses.
 - Once hit 25% threshold, can count excluded uses towards meeting 50% threshold.
- ▶ If 50% QBU failed in subsequent years, must recapture excess depreciation by reference to applicable straight-line schedule.

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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.

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Legislative History (1 of 3)

- ▶ “Bonus Depreciation” was originally enacted as part of the **Job Creation and Worker Assistance Act of 2002** and was expanded soon thereafter as part of the **Jobs and Growth Tax Relief Reconciliation Act of 2003**, but Bonus Depreciation was only a temporary stimulus measure and expired a few years later.
 - Regulations implementing Bonus Depreciation were published by the IRS at 1.168(k)-1 in September 2003.

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Legislative History (2 of 3)

▶ The Tax Cuts and Jobs Act of 2017 (the “2017 Act”)

- Expanded the scope of “Qualified Property” that is eligible for bonus depreciation to include used property;
- Increased the portion of the basis of Qualified Property that may be immediately expensed to 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;
- Authorizes expensing of 80% of the basis of qualified Property placed in service after December 31, 2022, and before January 1, 2014;
- Authorizes expensing of 60% of the basis of Qualified Property placed in service after December 31, 2023, and before January 1, 2025;

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Legislative History (3 of 3)

- Authorizes expensing of 40% of the basis of Qualified Property placed in service after December 31, 2024, and before January 1, 2026;
- Authorizes expensing of 20% of the basis of Qualified Property placed in service after December 31, 2025, and before January 1, 2027; and
- Extends all of the above placed in service deadlines by an additional year (for Certain Aircraft and Property having Long Production Times).

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- ▶ The Internal Revenue Service published proposed rules amending Treasury Regulation Section 1.168(k)-1 to implement the changes to Bonus Depreciation made by the 2017 Act on August 8, 2018 (the “Proposed Rules”).
- ▶ The deadline for submission of public comments to the Proposed Rules was October 9, 2018.
- ▶ Final action on the Proposed Rules is pending.

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Accounting Mechanics

- ▶ A taxpayer's remaining basis after deducting the appropriate bonus depreciation allowance is depreciated under standard depreciation principles (i.e., MACRS). (Obviously, does not apply to property qualifying for Bonus Depreciation at the 100% level).
- ▶ For example, assuming an aircraft placed in service during a 50% Bonus Depreciation year is depreciable under a five-year MACRS depreciation schedule, and the half-year convention, total first year deduction is 60% (i.e., 50% Bonus Depreciation Allowance, plus 20% of the remaining 50% under MACRS).

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MACRS Schedules

▶ Asset Class 00.21

- Airplanes (airframes and engines) except those used in commercial or contract carrying of passengers or freight, and all helicopters (airframes and engines), (e.g., “Corporate Aircraft” and helicopters)
- Six Year Class Life
- **Five Year MACRS Recovery Period**

▶ Asset Class 45.00

- Air Transport: Includes assets (except helicopters) used in commercial and contract carrying of passengers and freight by air, (e.g., commercial and charter aircraft).
- Twelve Year Class Life
- **Seven Year MACRS Recovery Period**

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Used Aircraft Must Meet the 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, and
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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Text of Relevant Portions of IRC Section 179

▶ **(d) DEFINITIONS AND SPECIAL RULES**

▶ **(2) PURCHASE DEFINED** The term “purchase” means any acquisition of property, but only if:

- **(A)** The property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b) (but, in applying section 267(b) and (c) for purposes of this section, paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants),
- **(B)** The property is not acquired by one component member of a controlled group from another component member of the same controlled group, and
- **(C)** The basis of the property in the hands of the person acquiring it is not determined—**(i)** in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or **(ii)** under section 1014(a) (relating to property acquired from a decedent).

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What are “Certain Aircraft”?

- ▶ The Act extends all of the placed in service deadlines by an additional year for “Certain Aircraft” & “Property Having Long Production Times”.
- ▶ “Certain Aircraft” are aircraft which meet the general definition of Qualified Property, and, in addition:
 - Are acquired by the taxpayer (or acquired pursuant to a written contract entered into) before January 1, 2027;
 - Are placed in service by the taxpayer before January 1, 2028;
 - Are not “Transportation Property” other than for agricultural or firefighting purposes;
 - On which such purchaser, at the time of the contract for purchase, has made a nonrefundable deposit of the lesser of 10% of the purchase price, or \$100,000;
 - Have an estimated production period exceeding 4 months; and
 - Have a cost exceeding \$200,000.

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What is a “Written Binding Contract”?

- ▶ Regulations provide that a contract is binding only if it is enforceable under State law against the taxpayer or a predecessor, and does not limit damages to a specified amount (for example, by use of a liquidated damages provision); however, a contractual provision that limits damages to an amount equal to at least 5 percent of the total contract price will not be treated as limiting damages to a specified amount.

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What is “Transportation Property”?

- ▶ “**Transportation Property**” is tangible personal property used in the trade or business of transporting persons or property. This could include all corporate aircraft that are predominantly used in charter, however, no definitive guidance exists.

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What is “Property Having Long Production Periods”? (1 of 4)

- ▶ In order for property to be considered “Property Having Long Production Periods” the property meet the general definition of Qualified Property, and, in addition:
 - Be acquired by the taxpayer (or acquired pursuant to a written contract entered into) before January 1, 2027;
 - Be placed in service by the taxpayer before January 1, 2028;
 - Either have a recovery period of at least 10 years (aircraft generally have shorter recovery periods) or be “Transportation Property”;
 - The property must be subject to IRC Section 263(A) (which applies to real or tangible personal property produced by the taxpayer); and
 - The property must have an estimated production period (i.e., the time from the date production actually begins until the date the aircraft is ready to be placed in service) exceeding 1 year, and a cost exceeding \$1,000,000.

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What is “Property Having Long Production Periods”? (2 of 4)

- ▶ This last requirement will eliminate many business-class aircraft that are “Transportation Property” and are placed in service in an extension year from qualifying for Bonus Depreciation under the “Property Having Long Production Periods” provision. Notwithstanding the fact that many makes/models of business aircraft have waiting lists that are several years long, few corporate jets actually have production periods exceeding 1 year.

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What is “Property Having Long Production Periods”? (3 of 4)

- ▶ If an aircraft placed in service in 2027 qualifies as “Property Having a Long Production Period,” the bonus depreciation allowance applies only to that portion of the adjusted basis of such aircraft attributable to manufacture, construction, or production before January 1, 2027.
- ▶ How do you calculate that portion of the adjusted basis of such aircraft attributable to manufacture, construction, or production before January 1, 2027?

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What is “Property Having Long Production Periods”? (4 of 4)

- ▶ Neither the statute, nor the regulations answer the question. However, when Bonus Depreciation was first enacted in 2002, Congress did state that it intended that rules similar to Section 46(d)(3) of the Internal Revenue Code that was in effect prior to the Tax Reform Act of 1986 should be applied.
- ▶ According to Section 46(d)(3), where property is produced for a taxpayer by another party (e.g., an OEM), the amounts that would be attributable to production in a given year would likely be the lesser of (i) the amounts paid during such year, and (ii) the amount which represents that portion of the overall cost of the construction which is properly attributable to that portion of such construction which is completed in such year.

Bonus Depreciation Update

Qualified Property: Exclusion of Alternative Depreciation System Property (1 of 6)

- ▶ 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, determined:
 - **(i)** Without regard to IRC 168(g)(7) (relating to a taxpayer’s election to have system apply); and
 - **(ii)** After application of IRC 280F(b) (relating to listed property with limited business use).

Bonus Depreciation Update

Qualified Property: Exclusion of Alternative Depreciation System Property (2 of 6)

- ▶ 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.

Bonus Depreciation Update

Qualified Property: Exclusion of Alternative Depreciation System Property (3 of 6)

▶ 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.

Bonus Depreciation Update

Qualified Property: Exclusion of Alternative Depreciation System Property (4 of 6)

▶ 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).

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Qualified Property: Exclusion of Alternative Depreciation System Property (5 of 6)

▶ 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.

Bonus Depreciation Update

Qualified Property: Exclusion of Alternative Depreciation System Property (6 of 6)

- ▶ Aircraft Used Predominately Outside the United States are Subject to ADS.
 - 50% test: an aircraft will not be deemed to be used predominantly outside the U.S. if the number of days during the applicable taxable year that the aircraft is physically present within the U.S. exceeds the number of days that the aircraft is physically outside the United States.
 - Aircraft operated to and from the United States with some degree of frequency: if the 50% test is failed, the taxpayer can still avoid treating the aircraft as being used predominantly outside the U.S. if the aircraft is operated to and from the U.S. with some degree of frequency on a scheduled or unscheduled basis.
 - What constitutes some degree of frequency is a question of fact.
 - The IRS held in Rev. Rul. 73-367 that a commercial airline met the "some degree of frequency" standard with respect to an aircraft operated on a regular schedule that included a single stop in the United States approximately once every two weeks.



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