

Aviation Tax Law Seminar

-Sponsored by Bombardier Aerospace Corporation-

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Tax Impacts of Personal and/or

Entertainment/Recreation/Amusement Use of Business Aircraft



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Agenda

- Tax Impacts of Personal and/or Entertainment/Recreation/Amusement Use of Corporate Aircraft:
 - Tax impact to the employee: fringe benefits and the Standard Industry Fare Level (SIFL)
 - Tax impact to the company: IRC 274 tax disallowance



**Tax impact to the employee:
Fringe Benefits and the Standard
Industry Fare Level (SIFL) Method**



Tax Impact on Employees

→ When employee uses company aircraft for personal, non-business transportation --

- **IRS Rule:** either
 - employee must reimburse company for costs of the transportation, or
 - Company must impute fringe benefit income to employee for value of the transportation
- **FAA Rule:** company cannot accept reimbursement from employee under Part 91



Tax Impact on Employees

→ In order to comply with both the **IRS Rule** and the **FAA Rule**, the company's only option is to impute fringe benefit income to the employee for value of the transportation



Tax Impact on Employees

- Two methods to determine value of the transportation for fringe benefit purposes:
 - Fair charter value method
 - Standard industry fare level (SIFL) method

- Consistency requirement



SIFL Formula

→ Simple mathematical formula that factors in:

- Status of employee (control employee vs. non-control employee)
- Number of family members/guests accompanying employee
- Weight class of aircraft
- Distance flown



SIFL Formula

- The SIFL formula also includes cents-per-mile rates and terminal charges that are adjusted and published semi-annually by the U.S. Department of Transportation
- These "SIFL Rates", are generally re-published by the IRS in revenue procedures shortly after publication by the Department of Transportation, and are usually posted on the web site of the National Business Aviation Association (www.nbaa.org)



SIFL Formula

→ "Control Employees" include

- Board or shareholder appointed, confirmed or elected officers, limited to the lesser of (1) one percent of all employees or (2) ten employees
- Among the top one percent of highly compensated employees, limited to a maximum of 50
- Owners of five percent or greater equity, capital or profits interest of the company
- Directors of the company



Defining the Flight to be Valued under SIFL

- The SIFL formula is applied on a flight by flight basis, with each takeoff and landing being treated as a single flight
 - A round-trip flight is treated as two separate flights
 - Similarly, a one-way trip with a stopover at an intermediate destination is treated as two separate flights, unless the intermediate stop is made for any reason unrelated to the personal purposes of the employee whose flight is being valued



Defining the Flight to be Valued under SIFL

- Where a flight is provided to an employee to a particular destination for a combination of personal and a business purposes, income is imputed only if the personal purpose of the flight is primary
- The determination of whether a flight is primarily for personal or business purposes is based on a facts and circumstances analysis



Tax Impact on the Company: IRC 274 Tax Disallowance



American Jobs Creation Act of 2004

- Section 274 of the tax code limits deductions for expenses of facilities (including aircraft) used for entertainment, amusement or recreational purposes
- The American Jobs Creation Act of 2004 (the “Act”) amended Section 274 to overrule the Sutherland Lumber decision for aircraft expenses incurred after October 22, 2004



American Jobs Creation Act of 2004

- Old Law: Expenses for employees' personal, non-business flights were fully deductible under Sutherland Lumber if income was imputed to the employee for the value of the flight (e.g., *SIFL*)
- New Law: Expenses for entertainment, amusement, and recreational flights of "Specified Individuals" are now deductible only **UP TO** the amount of income imputed to (or reimbursement received from) the Specified Individuals



American Jobs Creation Act of 2004

→ The Act raised more questions than it answered. Consequently, the IRS issued Notice 2005-45 in 2005, followed by proposed regulations in 2007, to answer many open questions



Overview of Notice 2005-45

- Issued on June 14, 2007, with a public comment period extending to September 13, 2007.
- The proposed regulations soften the impact, but do not overrule, several objectionable provisions of Notice 2005-45
- The proposed regulations do NOT adopt the “primary purpose” test advocated by industry groups, which would characterize an entire flight as business or entertainment



Overview of Proposed Regulations

- Issued on June 14, 2007, with a public comment period extending to September 13, 2007
- The proposed regulations soften the impact, but do not overrule, several objectionable provisions of Notice 2005-45
- The proposed regulations do NOT adopt the “primary purpose” test advocated by industry groups, which would characterize an entire flight as business or entertainment



Overview of Proposed Regulations

→ For tax years beginning **prior to** the date the IRS publishes a notice of final adoption of the regulations, taxpayers may apply either Notice 2005-45 or the proposed regulations



Who is a Specified Individual?

- The term “Specified Individuals” includes all officers, directors and persons directly or indirectly owning more than 10% of any equity class of the taxpayer, or any related party (within the meaning of IRC §§ 267(b) or 707(b))
- Applies to private companies, publicly-held companies, partnerships, and tax-exempt entities
 - Includes spouse, family members or guests of the specified individual
 - The Proposed Regulations request comments on how the regulations could define passengers by virtue of their relationship to a Specified Individual



What is Entertainment?

- Sports events
- Hunting
- Fishing
- Golfing
- Travel to Country Clubs
- Skiing
- Resort Destinations



What Activities are Personal, but do not Constitute Entertainment?

- Commuting
- Travel to a funeral
- Travel to for medical purposes
- Travel for charity work
- Travel for business other than that of the employer
- Travel to meetings with personal advisors
- Transportation between homes not associated with entertainment



Travel for Both Business and Recreational Purposes

Single Destination

- Notice 2005-45 does not address how to determine whether a Specified Individual's trip to a particular destination should be categorized as business or recreational, when both activities are conducted
- Existing regulations governing the imputation of fringe benefits provide that income must be imputed to an employee only if the personal purpose of the employee in traveling to a particular destination is primary
- In light of the absence of guidance in the Notice and the Proposed Regulations, it should be reasonable to assume that a similar methodology may be used



Travel for Both Business and Recreational Purposes

Multiple Destinations

- When a flight provided to a Specified Individual includes one or more destinations for business purposes, and one or more other destinations for entertainment purposes, the flight hours/miles allocated to entertainment use will be the excess of the total flight hours/miles flown during the trip over the number of flight hours/miles that would have been flown if the flights to the entertainment destinations had not occurred



Special Rules for Deadhead Flights

→ Notice 2005-45: When an aircraft is flown empty to pick up or to drop off one or more passengers, the empty flight is treated as having the same number and character (i.e., business vs. entertainment) of passengers as the flight for which passengers are on board



Special Rules for Deadhead Flights

- Proposed Regulations expanded the Notice to provide that the allocation of passengers and expenses to a deadhead flight occurring between two occupied flights is based on the number of passengers on board for the two occupied legs
- Example: Aircraft flies from point A to point B to drop off a business traveler, then deadheads from point B to point C to pick up an entertainment traveler who flies from point C to point A



What Expenses are Subject to Disallowance?

- Notice 2005-45: Taxpayers must include tax depreciation, as well as all expenses of operating and maintaining the aircraft during the taxable year, including, for example:
- fuel
 - landing fees
 - overnight hangar fees
 - catering
 - meal and lodging expenses of the flight crew
 - management fees
 - hangar rent
 - salaries of pilots
 - maintenance personnel and other personnel assigned to the aircraft
 - maintenance costs
 - lease payments (if aircraft is leased rather than owned)
 - charter fees (if aircraft is chartered rather than owned)



Special Rules Regarding Depreciation Expense

→ Pursuant to the Proposed Regulations:

- Taxpayers may elect to calculate depreciation using the straight-line method over the class life of the aircraft solely for purposes of calculating the amount of the disallowed expense, even if another method is used for tax or book purposes
- The election may be made for aircraft placed in service in prior years. In such cases, apply straight line to original basis as if the election had been in effect since the aircraft was placed in service
- If taxpayer elects to use the straight-line method for one aircraft, it must use the method for all aircraft it owns



Special Rules Regarding Depreciation Expense

- Election may only be revoked for compelling reasons with IRS consent
- Tax basis is only reduced by the amount of depreciation actually allowed after application of the disallowance rules (i.e., disallowed depreciation is added back to basis upon a sale of the aircraft)
- The expense disallowance provisions are applied on a pro-rata basis to all of the disallowed expenses



Aggregating Costs of Multiple Aircraft

- Notice 2005-45: aircraft with similar cost profiles may be grouped together when determining the expenses
- Proposed Regulations expanded the provisions of the Notice to provide that aircraft have similar cost profiles if their operating costs per hour or flight are comparable, and they have the same number and type (i.e., jet or propeller) of engines. Other factors to consider include payload, seating capacity, fuel consumption rate, age, maintenance costs, and depreciable basis



Arm's Length Charters/Leases

- Third Party Charter/Dry Lease: under the Proposed Regulations, expenses allocable to leases or charters to unrelated third-parties in bona-fide transactions for full and adequate consideration may be excluded
- The text further provides that “only expenses allocable to the charter period are not taken into account”
- Query: Does this include a pro-rata share of depreciation and fixed expenses?



Arm's Length Charters/Leases

→ Charter/Dry Lease to Specified Individuals: the Proposed Regulations do not address expenses allocable to leases or charters to Specified Individuals at arm's length rates. The IRS has stated, however, that the exception in the preceding slide does not apply to such transactions



Charter Rate Safe Harbor

- Proposed Regulations: no charter rate safe harbor currently exists; however, the proposed regulations indicate that such a safe harbor is under consideration and the IRS has invited comments on the concept
- A charter rate safe harbor could be very advantageous for high basis aircraft



Bona Fide Security Concerns

→ Proposed Regulations: a corporate requirement that an executive utilize the corporation's aircraft for all air travel (business and entertainment) as part of a corporate security plan does NOT convert entertainment travel to business travel



Impacts on Aircraft Owners/Operators and the Business Aircraft Industry

- Inclusion of tax depreciation as an “expense” disproportionately impacts owners who have not yet fully depreciated their aircraft
- Electing to use the straight-line method may help to alleviate the tax cost of entertainment use during the first few years of ownership, but may increase the tax cost in later years during which the aircraft would otherwise have been fully depreciated but for the election to use the straight line method



GKG Law Strategies for Avoiding/Minimizing Disallowance of Aircraft Expense Deductions

- Permit/increase use by unrelated third-parties under Aircraft Dry Leases, and/or Part 135 Charter at arm's-length rates
- Be thoughtful on assessing what is entertainment versus non-entertainment
- Encourage use of supplemental lift (charter, jet cards, etc., in lieu of the company jet for entertainment trips



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Aviation Tax Law Seminar

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Record Keeping and Reporting for Personal and Entertainment/Recreation/Amusement Use of Business Aircraft



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Reporting for Personal Use under the Standard Industry Fare Level (SIFL) Method



SIFL

- SIFL method is used to value a fringe benefit provided as compensation for services
- Not applicable to owner of SMLLC or sole proprietorship
- Employee is imputed income for value of his/her own transportation, as well as for the value of transportation provided to his/her family members and guests
- Income is typically reported on W-2, K-1 or 1099



SIFL

- Only applies to employee's personal (not business) travel
- Personal travel may or may not be for entertainment/recreation/amusement purposes
- Personal includes travel for employee's business other than the business of the employer



SIFL

- Step 1: determine distance flown in **statute** miles
- Step 2: multiply mileage by applicable SIFL rates (rates change every 6 months – published by IRS and NBAA)



SIFL Rates for 01/01/10 – 06/30-10

- 0-500 miles: \$ 0.2204
- 501-1,500 miles: \$ 0.1680
- Over 1,500 miles: \$ 0.1615
- Terminal Charge: \$ 40.28



SIFL

→ Step 3: multiply by aircraft weight class multiplier

Weight Class	Control Employee	Non Control Employee
0 - 6,000	0.625	0.156
6,001 - 10,000	1.250	0.234
10,001 - 25,000	3.000	0.313
25,001 and up	4.000	0.313



SIFL

- Step 4: add terminal charge
- Step 5: multiply by number of passengers traveling for personal purposes (e.g., employee plus family and guests)
- Step 6: repeat for each leg



SIFL Example

→ In January, 2010, a control employee, and his/her spouse and three children, travel on the employer's aircraft (Bombardier Challenger) round trip (1,800 miles each way) for personal purposes (e.g., vacation)



SIFL Example Calculation

Leg 1:

First 500 miles x \$0.2204 = \$110.20

Next 1000 miles, x \$0.168 = \$168.00

Last 300 miles x \$0.1615 = \$ 48.45

\$326.65

Aircraft weight class multiplier: x 4.0

\$1,306.60

Add Terminal Charge: \$40.28

\$1,346.88

Number of passengers: x 5

Total SIFL (Leg 1): \$6,734.40

Repeat for Return Trip (Leg 2)



Flight Valuation Consistency Rule

- Existing regulations provide that an employer may value employee personal use flights using either the SIFL method, or the fair charter value method, but requires that if any flight is valued using the SIFL method, all flights in that taxable year must be valued under the SIFL method
- Notice 2005-45 and the Proposed Regulations modify the consistency requirement and allow employers to value travel for Specified Individuals traveling for recreational purposes under the fair charter value method while continuing to value other travel, including recreational travel by non-Specified Individuals, under the SIFL method



Record Keeping and Reporting for IRC 274 Tax Disallowances for Entertainment/Recreation/Amusement Use



Record Keeping and Calculations under Notice 2005-45

- The taxpayer must maintain records of all aircraft expenses, and either the total number of flight hours or miles flown by each individual passenger on each flight of the aircraft, and then must categorize the hours or miles flown by each individual on each flight in one of 3 buckets: business, personal entertainment, or personal non-entertainment

Business



Personal Entertainment



Personal Non-Entertainment



Record Keeping and Calculations under Notice 2005-45

→ Assume 5 passengers on board (all Specified Individuals), of which 3 are traveling on business, 1 is traveling for personal entertainment, and 1 is traveling for personal non-entertainment. The trip is 1,000 miles, and the seat miles methodology is used:

	<u>Passengers</u>	<u>Miles</u>	<u>Total Seat Miles</u>
Business	3	1,000	3,000
Personal Entertainment	1	1,000	1,000
Personal Non-Entertainment	1	1,000	1,000



Record Keeping and Calculations under Notice 2005-45

- At the end of the tax year, all occupied seat miles (or hours) in all three buckets are totaled
- The sum of all expenses subject to disallowance is divided by the total sum of occupied seat miles (or hours) in all 3 buckets
- The average cost per occupied seat mile (or hour) for the taxable year is determined



Allocating Expenses to Business and Entertainment Uses

→ The average cost per occupied seat mile (or hour) for each flight is multiplied by the total number of entertainment occupied seat miles (or hours) to determine the entertainment expenses associated with the flight



Allocating Expenses to Business and Entertainment Uses

- The total amount imputed as income to, or reimbursed by, the Specified Individual for the entertainment flight (not to exceed the entertainment expenses associated with the flight) is subtracted from the entertainment expenses associated with the flight to determine the amount disallowed



Calculating Disallowed Expenses

- Under the Proposed Regulations, the Notice 2005-45 methodology is retained, but an alternative methodology is also permitted whereby:
- All costs and expenses are allocated on a flight-by-flight basis based on an average cost per hour or mile calculation
 - The costs and expenses allocated to each flight are then apportioned to the passengers on a per capita basis



Calculating Disallowed Expenses

- Those costs and expenses apportioned to “Specified Individuals” traveling for entertainment purposes are disallowed
- The gross amount of the disallowance attributable to a given flight is then reduced by the amounts imputed as income (e.g., SIFL) to the Specified Individual and/or reimbursed by the Specified Individual to the company



Calculating Disallowed Expenses

→ Example:

- Taxpayer conducts ten flights during the year between the same two city pairs. On the first nine flights, a Specified Individual travels alone for business purposes, and on the 10th flight a Specified Individual and 8 of his family members travel for recreational purposes.
 - Notice 2005-45 Result: 50% of the total expenses for the year would be subject to disallowance
 - Alternative Methodology: 10% of the expenses for the year would be subject to disallowance



Calculating Disallowed Expenses

→ Whether the new flight-by-flight approach will benefit any given taxpayer will be difficult to determine until the tax year is over and a calculation can be made under both methodologies to determine which methodology produces the smaller disallowance of expenses for the year



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Tax-Free Exchanges Under IRC § 1031



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Your Tax Concerns

- Your aircraft has been fully (or nearly fully) depreciated for tax purposes
- Your aircraft has significant market value



Your Tax Concerns Cont...

- ✈ You want to sell your aircraft and use the proceeds to buy another aircraft, but the sale of your “old” aircraft could result in millions of dollars of recapture, all of which could be taxable at ordinary tax rates



Your Solution

→ If you "exchange" your old aircraft for your "new" aircraft in a transaction qualifying under Section 1031 of the Internal Revenue Code, you may be able to defer recognition of some or all of the gain from the sale of the old aircraft



Issues?

- Qualifying a transaction under Section 1031 can be complicated
- Transaction form and timing are critical



Issues Cont...

- An inadvertent or relatively minor timing or documentation error in an otherwise properly structured transaction can cause the whole transaction to fail to qualify under Section 1031



Statutory Elements of a Tax-Free Exchange

- You must have held your old aircraft for productive use in a trade or business, or for investment
- You must hold your new aircraft for productive use in a trade or business, or for investment



Statutory Elements of a Tax-Free Exchange Cont...

- Your new aircraft must be “like-kind” to your old aircraft
- You must NOT sell your old aircraft and purchase your new aircraft in separate transactions, but rather must exchange your old aircraft for your new aircraft



Statutory Elements of a Tax-Free Exchange Cont...

- You must recognize gain to the extent of any cash or any other non-qualifying property received in the exchange
- Your basis in your new aircraft will be adjusted downward by the amount of gain deferred by the exchange



Multi-Party Exchange and Deferred Exchange Safe Harbors

→ If you are not actually selling your old aircraft to the same party from whom you will purchase your new aircraft (e.g. an OEM), the transaction must be structured as a multi-party exchange



Multi-Party Exchange and Deferred Exchange Safe Harbors Cont...

- In multi-party exchanges, the sale of the old aircraft and the purchase of the new aircraft may occur simultaneously, or up to 180 days apart



Multi-Party Exchange and Deferred Exchange Safe Harbors Cont...

- If you will close the purchase of your new aircraft within 180 days subsequent to the closing of the sale of the old aircraft, you must structure the transactions as a “Forward Exchange”



Multi-Party Exchange and Deferred Exchange Safe Harbors Cont...

- If you will close the purchase of your new aircraft within 180 days prior to the closing of the sale of the old aircraft, you must structure the transactions as a “Reverse Exchange”



Forward Exchange Basics

- Authorized by Treasury Regulations § 1.1031(k)-1
- Qualified Intermediary (“QI”) acts as middleman in sale of the old aircraft and acquisition of new aircraft



Forward Exchange Basics Cont...

- You and QI enter into an Exchange Agreement which restricts your rights to receive proceeds from the sale of the old aircraft
- Proceeds from the sale of the old aircraft are held in a qualified escrow account or a qualified trust account pending purchase of the new aircraft



Forward Exchange Basics Cont...

- You **must** either acquire the new aircraft, **or** specifically identify the aircraft that will be acquired, **within 45 calendar days** after completion of the sale of the old aircraft.
- You may be allowed to identify multiple and/or alternate aircraft



Forward Exchange Basics Cont...

→ You **must** complete your acquisition of the new aircraft no later than the earlier of:

(1) the **180th calendar day** after completion of the sale of the old aircraft; or . . .



Forward Exchange Basics Cont...

(2) the due date (including extensions) of your Federal income tax return for the taxable year in which the sale of the old aircraft occurred



Reverse Exchange Basics

→ Authorized by IRS Revenue Procedure 2000-37, 2000-40 IRB 1 (September 15, 2000)



Reverse Exchange Basics Cont...

- Procedures are similar to Forward Exchange, except that an Exchange Accommodation Titleholder ("EAT") holds title to either the old aircraft (a "Front-End Reverse Exchange"), or the new Aircraft (a "Back-End Reverse Exchange") until a closing of the sale of the old aircraft can be arranged. (The EAT usually also performs the QI function)



Reverse Exchange Basics Cont...

→ You and EAT must enter into a Qualified Exchange Accommodation Agreement



Reverse Exchange Basics Cont...

→ You **must** either complete a sale of the old aircraft to a third-party buyer, or specifically identify the aircraft that will be sold, within **45 calendar days** after the acquisition of the new aircraft by you in a Front-End Reverse Exchange, or by the EAT in a Back-End Reverse Exchange



Reverse Exchange Basics Cont...

- The sale of the old aircraft **must** be completed no later than: the **180th calendar day** after the acquisition of the new aircraft by you in a Front-End Reverse Exchange, or by the EAT in a Back-End Reverse Exchange; OR
- The due date of the taxpayer's federal tax return, including extensions, if prior to 180 days



Common Questions

→ 1) Who may and who may not serve as Qualified Intermediaries and/or Qualified Exchange Accommodation Titleholders? (e.g., Lawyers, Accountants, Aircraft Brokers)



Common Questions Cont...

→ 2) Can I use an aircraft broker to take title to my old aircraft or to pass title to the new aircraft?



Common Questions Cont...

→ 3) Are OKC escrow accounts "Qualified" escrow accounts?



Common Questions Cont...

→ 4) In a forward exchange, can I take title to a **green** aircraft in exchange for my old aircraft?



Common Questions Cont...

→ 5) Can I make progress payments on a new aircraft?



Common Questions Cont...

- 6) Can I exchange my aircraft for:
1. An interest in a partnership that owns a different aircraft?
 2. A 100% interest in a limited liability company that owns a different aircraft?
 3. A fractional interest in a new aircraft?



Common Questions Cont...

→ 7) Can I trade two old aircraft for one new aircraft in a single 1031 transaction?



Common Questions Cont...

→ 8) Can I exchange my old aircraft for a new aircraft of lesser value and receive the price difference in cash tax-free?



Common Questions Cont...

→ 9) What happens if I do a Reverse Exchange and can't sell my old aircraft within 180 days of the purchase of my new aircraft?



Common Questions Cont...

→ 10) Will my exchange qualify as a “trade-in” for state sales and use tax purposes?



Special Rules: Like-Kind Exchanges

- Bonus Depreciation applies in the year the replacement property is placed in service
- Both the **Carryover Basis** (i.e., the basis in the relinquished aircraft), and the **Excess Basis** (i.e., additional cash paid in the exchange), are eligible for Bonus Depreciation
- Depreciation (Bonus and MACRS) is computed separately for the Carryover Basis and the Excess Basis



Special Rules: Like-Kind Exchanges

→ MACRS tables can be used to calculate annual depreciation on that portion of the Excess Basis that remains after deducting Bonus Depreciation



Special Rules: Like-Kind Exchanges

- Deduction Attributable to Relinquished Aircraft in Year of Exchange has 3 components:
 1. MACRS deduction applicable to that portion of the year preceding the exchange (apply applicable convention)
 2. Bonus Depreciation on remaining Carryover Basis
 3. MACRS deduction applicable to that portion of the year after the exchange



Special Rules: Like-Kind Exchanges

- Deduction Attributable to Replacement Aircraft in Year of Exchange usually has 2 components, but may have 3 components if Section 179 expensing also applies:
1. Section 179 expensing deduction, if applicable
 2. Bonus Depreciation
 3. MACRS deduction





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Putting it All Together: Aircraft Ownership and Operations Planning for Business, Personal and Charter Use



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Objectives of Proper Legal Structure

- Minimize State Sales and Use Taxes
- Economic Considerations - Cost Sharing
- Maximize Federal Tax Deductions
- Liability Protection Planning and FAA Compliance (Often Overlooked)



Planning an Ownership Structure

- Minimize Sales and Use Taxes
 - Often Form Over Substance
 - Sales Taxes: Critical in determining aircraft delivery location
 - Use Taxes: Critical in determining hangar location



Planning an Ownership Structure

→ Minimize Sales and Use Taxes

- Common Exemptions and Exclusions:
 - Sale-for-Resale/Lease
 - Common Carrier
 - Interstate Commerce
 - Occasional/Casual Sale
 - Fly Away



Planning an Ownership Structure

- Factor in Economic Considerations
 - Aircraft/Transportation Acquisition Options
 - Traditional whole aircraft ownership
 - Joint ownership of aircraft assets
 - Joint ownership of aircraft-owning entities
 - Turn-key managed joint ownership
 - Fractional ownership
 - Fractional Lease / Card
 - Charter



Planning an Ownership Structure

→ Factor in Economic Considerations

- Financing Options
- Traditional Debt Financing
- Operating Lease Financing
- Internal Financing



Planning an Ownership Structure

→ Factor in Economic Considerations

- Cost Sharing by Affiliated Entities
 - FAA definition of Affiliated Group and FAR 91.501(b)(5) reimbursement for affiliated groups
 - IRS definition of Affiliated Group and FET implications



Planning an Ownership Structure

- Factor in Economic Considerations
 - Incorporating Third-Party Charter into Aircraft Operations Plan



Planning an Ownership Structure

→ Factor in Federal Tax Planning

- Depreciation
- MACRS vs. ADS
- 280F:
 - Qualified Business Use
 - 25% and 50% Tests
 - TAM 200945037



Planning an Ownership Structure

→ Factor in Federal Tax Planning

- Depreciation (cont.)
- Commercial vs. Non-Commercial
- MACRS: 5 year vs. 7 year
- ADS: 6 year vs. 12 year



Planning an Ownership Structure

→ Factor in Federal Tax Planning

- Deductibility of Operating Expenses
 - Ordinary, Necessary and Reasonable
 - 162 vs. 183
- At-Risk and Passive Activity Losses
 - 465
 - 469



Planning an Ownership Structure

→ Factor in Federal Tax Planning

- Personal and Entertainment Use
 - IRC Section 61 – SIFL
 - Income Inclusion for individual
 - IRC Section 274
 - Limitation on corporate deduction



Planning an Ownership Structure

→ Factor in Federal Tax Planning

- Federal Excise Taxes
 - Air Transportation Taxes
 - Domestic vs. International
 - Possession, Command and Control
 - Applicability to charges/bookkeeping entries for shareholder and related entity flights
 - Fuel Taxes



Planning an Ownership Structure

→ Factor in Federal Tax Planning

- Tax-Free Exchanges - 1031
 - Forward
 - Reverse



Planning an Ownership Structure

→ FAA Compliance and Liability Protection Planning

- FAA Compliance:
 - Flight Department Companies
 - Other FAA/FAR Issues (often form over substance)
- Insurance



Planning an Ownership Structure

→ FAA Compliance and Liability Protection Planning

- Corporate Attorneys, Risk Managers, and CFO's who lack corporate aviation expertise often consider liability protection planning first, and conclude (incorrectly) that a Flight Department Company is required to minimize risk.



Planning an Ownership Structure

→ FAA Compliance and Liability Protection Planning

- Problems with Flight Department Companies
 - Limited opportunities for exemption from sales and use taxes
 - Impact on Insurance Coverage
 - FAA Civil Penalties
 - Federal Excise Taxes



Planning an Ownership Structure

→ Additional Planning Issues

- FAA Registration and Citizenship
- Accounting Issues
- SEC/Public Company Issues

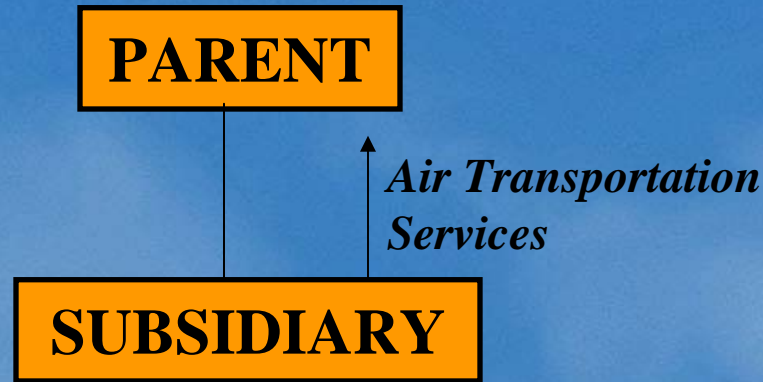


Planning an Ownership Structure

Examples



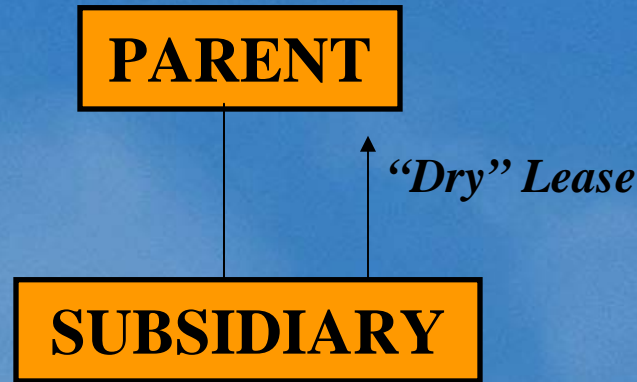
Typical Flight Department Company Structure



- Primary business operated by Parent
- Subsidiary employs (or contracts for) pilots
- Aircraft owned (or leased) and operated by Subsidiary; Subsidiary incurs all expenses for operations
- Subsidiary has no other business operations



Typical Sale for Resale Structure (No Charter)



- Primary business operated by Parent
- Subsidiary owns (or leases) Aircraft, and leases (subleases) to Parent
- Parent employs (or contracts for) pilots, and operates Aircraft



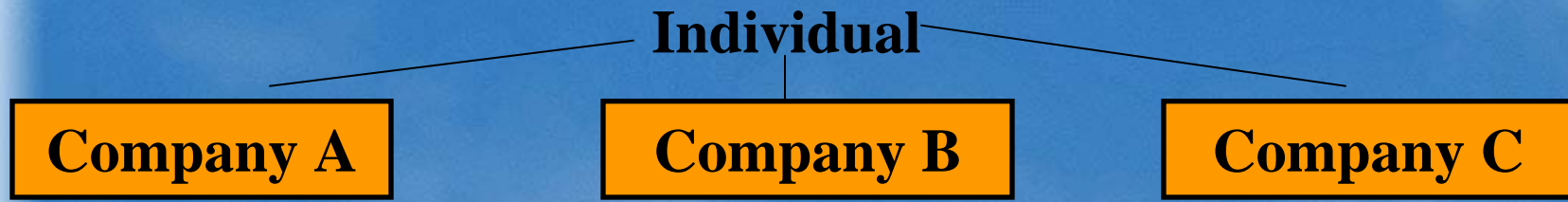
Typical Sale-for-Resale Structure (3rd Party Manager w/Charter)



- Primary business operated by Parent
- Subsidiary owns (or leases) Aircraft, and lease (subleases) it on a "non-exclusive" basis to both Parent and Manager
- Manager employs pilots and operates Part 135 flights
- Parent contracts for pilots and operates Part 91 flights



Federal Excise Taxes



- Company A, B and C are all S Corporations owned by the same person (or group of people)
- All 3 companies have operating businesses
- Company A also owns the aircraft, and allows Company B and C to use the aircraft for reimbursement of direct operating costs, and prorated fixed costs
- All payments made by Company B and C are subject to FET



Passive Activity Rules



- Company A is owned by the CEO of Company B
- Company A owns the aircraft and dry leases to Company B
- Company B employs (or contracts for) pilots, and operates the aircraft
- “Per Se” rental activity classification - passive activity dilemma



Passive Activity Rules



- Company A and B are both S corporations owned by the same person (or group of people)
- Company A owns the aircraft and dry leases the aircraft to Company B
- Company B employs (or contracts for) pilots, and operates the aircraft
- Exceptions to Per Se rental classification
- Grouping Election (Economic Unit) - Section 1.469-4



Closing Remarks



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