Tax Depreciation of Business Aircraft

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Tax advisors typically deal with two types of depreciation on depreciable business assets – book depreciation and tax depreciation, explain Keith Swirsky and Troy Rolf. Following is a high-level overview of tax depreciation concepts applicable to business aircraft other than "bonus" depreciation.

Book depreciation is a financial accounting concept requiring an adjustment be made to the value of an asset as listed in the books of a company to reflect a decline in the market value of the asset. Tax depreciation, meanwhile is an income tax concept that permits a taxpayer to deduct the entire cost of an asset on a pre-determined schedule, without regard to the actual rate of decline in the market value of the asset.

The Internal Revenue Code (the "Code") provides two methods for depreciating business aircraft – the Modified Accelerated Cost Recovery System (MACRS), and the Alternative Depreciation System (ADS).

Depreciation under ADS is based on a straight-line method and thus results in depreciation deductions being spread out equally over the applicable recovery period for the asset. The MACRS system, on the other hand, is a front-loaded system allowing for larger deductions in the first few years after the asset is placed in service than would be the case under ADS. Recovery periods for assets tend to be shorter under MACRS than ADS, thus further accelerating the deductions.

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Of course, the tradeoff for accelerating depreciation deductions is that less depreciation will be available to offset income in later years under MACRS than under ADS. Under either method, the total amount that may be deducted over the applicable recovery period is the same – 100% of the basis of the asset.

Not all business aircraft operators qualify to use MACRS. For those who do qualify, MACRS is considered the default system, but taxpayers may opt out of MACRS by making an affirmative election to use ADS instead. Opting out of MACRS is unusual, but may be appropriate if claiming the higher deductions available during the first few years of a MACRS schedule would result in excessive net losses. Those who do not qualify to use MACRS, but who nevertheless qualify to claim depreciation, must use ADS.

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DEPRECIATION FACTORS

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

Aircraft used for qualified business purposes or for the production of income (e.g., typical business-use Part 91 operations), 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, or under ADS over a recovery period of six years. For fixed-wing aircraft used in commercial or contract carrying of passengers and freight by air (e.g., typical Part 135 operations), the applicable MACRS recovery period is seven years, and the ADS recovery period is twelve years.

The tables below provide the depreciation deductions for business aircraft for each year under the five-year and seven-year MACRS schedules, and the six-year and twelve-year ADS schedules, for aircraft deemed to be placed in service at the middle of the year, given as a percentage of the original cost basis of the aircraft. All percentages are approximate. Percentages for aircraft deemed to have been placed in service in the middle of a calendar quarter will differ somewhat, depending on the quarter in which the aircraft was placed in service.

SPLIT PART 91 & 135 IMPACT

Where an aircraft is used part of the time in business-use Part 91 operations to which a MACRS recovery period of five years or ADS recovery period of six years would apply, and part of the time in Part 135 third-party charter operations to which a MACRS recovery period of seven years or ADS recovery period of twelve years would apply, the aircraft would be included in the asset class for the activity in which the aircraft is predominantly used. Changes in the predominant use from one year to another require adjustments to the depreciation schedule for the aircraft.

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 the fraction of the otherwise allowable deduction that bears the same ratio as the Business Uses of the aircraft during the taxable year bears to all the uses of the aircraft during the taxable year.

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, which defines deductible trade or business expenses.

It should be noted that with proper planning, the adverse tax effects described above arising from personal use of a business aircraft by an executive or other employee of a company can be eliminated or minimized. This is because IRS regulations in effect allow some personal use to be converted to "Business Use" for depreciation purposes.

This occurs when (1) the personal use is not for "entertainment, recreation or amusement" purposes, as defined in IRS regulations; (2) "fringe benefit income" is imputed to the executive or other employee under applicable IRS regulations; and (3) other types of Business Uses are at least 25% of all use.

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

MACRS SCHEDULES (HALF-YEAR CONVENTION)

Year:	1	2	3	4	5	6	7	8
5-YR	20.00%	32.00%	19.20%	11.52%	11.52%	5.76%	-	-
7-YR	14.29%	24.49%	17.49%	12.49%	8.93%	8.92%	8.93%	4.46%

ADS SCHEDULES (HALF-YEAR CONVENTION)

Year:	1	2-6	7	8-12	13
6-YR	8.333	16.667	8.333	-	-
12-YR	4.167	8.333	8.333	8.333	4.167