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Depreciation of Business Aircraft:

The Issues Board Members Should Consider

When and how a corporation depreciates an asset has a significant impact on whether to purchase, lease or charter business aircraft, notes Chris Younger.

The accounting phenomenon known as depreciation has many dimensions that impact a Board's decisions involving Business Aviation. For example, policies such as bonus and accelerated depreciation beg questions of when and if that feature of the tax code should be applied to optimize a company's tax liability. But there are many other considerations, as we outline below to illustrate the point that depreciation is indeed a sophisticated subject that deserves careful consideration by Directors.

To make the point that the subject has many moving parts, depreciation involves the following common issues that should be considered in Board deliberations involving acquisition and use of a business aircraft.

- The availability of bonus depreciation when purchasing a new aircraft and whether a company can utilize the full benefit of such depreciation;
- The effect of a tax deferred "like-kind-exchange" on the availability of depreciation and depreciation schedules, as well as the utility of engaging in an exchange in lieu of a taxable disposition of a relinquished aircraft;
- Whether to elect to use straight-line depreciation instead of accelerated depreciation under the Modified Accelerated Cost Recovery System (MACRS), and the potential ramifications of such a decision;
- The effect on the aircraft's depreciation schedule due to its use in charter operations; and
- The potential effect of certain statutory limitations on the company's ability to deduct tax depreciation including:
    - o Whether the IRS may disallow depreciation deductions because an aircraft ownership activity is not engaged in the furtherance of a "for profit" business under Code Section 183;
    - o Whether the amounts to be deducted are limited under the "at-risk" loss limitation rules of Code Section 465;
    - o Whether depreciation deductions will be limited due to the application of the passive activity loss limitation rules of Code Section 469;
    - o Whether personal entertainment use of a company aircraft will result in disallowance of a portion of the depreciation under Code Section 274;
    - o Whether, due to the ownership of the aircraft, the listed property rules of Code Section 280F will act to limit the availability of bonus or accelerated depreciation deductions.

OTHER USES FOR DEPRECIATION

If any of the foregoing limitations would apply to reduce or eliminate the amount of depreciation that a company can deduct, the Board should consider whether it is preferable for the company to enter into ›

What the Boardroom needs to know about Business Aviation

an operating lease of the aircraft with a financial institution that can utilize such tax depreciation. An operating lease may be an attractive alternative to the outright purchase, particularly if the company cannot utilize depreciation deductions attributable to the aircraft. The financial institution might be able to utilize those deductions and therefore offer the aircraft for lease at a competitive rent rate when compared with the company's cost of acquiring the aircraft without the benefit of depreciation deductions.

If the Board is considering the purchase of a new aircraft, and the aircraft is eligible for 50% bonus depreciation, Directors should determine whether or not the company can utilize that excess depreciation in the year in which it becomes available. If so, the decision to purchase an aircraft that is eligible for bonus depreciation could turn on the tax savings resulting from the company's deduction. Conversely, if the company cannot utilize bonus depreciation, the company may be better off purchasing a pre-owned aircraft with a lower acquisition cost and utilizing normal accelerated depreciation.

IMPACT ON BOARD DECISIONS

The Board's consideration of all of these factors will allow it to determine whether to acquire an aircraft at all; whether to acquire a new or used aircraft; whether to engage in a tax deferred like-kind-exchange of an existing aircraft for a newly acquired aircraft; whether a newly acquired aircraft should be operated in charter service; whether an aircraft should be made available to executives of the company in connection with personal entertainment transportation; and whether the company should purchase the aircraft itself or enter into an operating lease of the aircraft with a financial institution. Obviously, the issues involved are many and complex.

Additionally, a company should analyze all of the foregoing considerations in the context of assuring that what may be an optimal aircraft ownership and operating structure from an income tax standpoint also complies with state sales and use tax rules; the requirements of the Federal Aviation Regulations (which can often be counterintuitive; liability protection planning objectives; public company reporting requirements, if applicable; and Federal air transportation excise tax rules.

Due to the complexity inherent in the application of tax laws to aircraft acquisitions and operations, it is advisable for a Board to consult with knowledgeable aviation counsel to acquire the knowledge necessary to make an informed decision.

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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