



**Aviation Tax Law Webinar  
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**Bonus Depreciation, MACRS  
Depreciation, and IRC 280F**

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# Bonus Depreciation



# Legislation

- “**Bonus Depreciation**” was originally enacted after the September 11 terrorist attacks, and expired a few years later.
- The **Economic Stimulus Act of 2008** (the “2008 Act”) re-introduced the concept of Bonus Depreciation into the Tax Code for certain “Qualified Property” placed in service in 2008 (and, under certain circumstances, in 2009).
- The **American Recovery Reinvestment Act of 2009** (the “2009 Act”) extended each of the placed in service deadlines of the 2008 Act by an additional year (to 2009/2010).
- The **Small Business Jobs Act of 2010** (the “First 2010 Act”) extended each of the placed in service deadlines of the 2008 Act by yet another year (to 2010/2011).



# Legislation

- The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the “Second 2010 Act”) extended each of the placed in service deadlines of the 2008 Act by two more years (to 2012/2013), and increased the Bonus Depreciation Allowance from 50% to 100% for Qualified Property acquired between Sept. 8, 2010 and Dec. 31, 2011, and placed in service prior to January 1, 2012 (2013 for Certain Aircraft and Property having Long Production Times).



# Bonus Depreciation

→ The depreciation deduction for the taxable year in which “**Qualified Property**” is placed in service includes an allowance equal to either 50 or 100 percent of the adjusted basis of the Qualified Property (i.e., after adjustments under other sections of the IRC (e.g., Section 179)).



# Bonus Depreciation

→ Exception: for “Properties Having Long Production Periods” (defined later) that are placed in service in 2013, the bonus depreciation allowance applies only to that portion of the adjusted basis thereof attributable to manufacture, construction, or production before January 1, 2013.



# Bonus Depreciation

- A taxpayer's remaining basis after deducting the 50% allowance is depreciated under standard depreciation principles (i.e., MACRS). (Obviously, does not apply to property qualifying for 100% bonus).
- For example, assuming an aircraft 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).



# What is “Qualified Property”?

- “Qualified Property” is property which meets each of the following four requirements:
1. has a recovery period of 20 years or less (e.g., aircraft);
  2. the “Original Use” of the property commences with the taxpayer after December 31, 2007;



# What is “Qualified Property”?

→ 3.

- (i) is acquired by the taxpayer after December 31, 2007, and before January 1, 2013, but only if no “**Written Binding Contract**” for the acquisition was in effect before January 1, 2008, or
- (ii) is acquired by the taxpayer pursuant to a “**Written Binding Contract**” which was entered into after December 31, 2007, and before January 1, 2013; or
- (iii) in the case of **Self Constructed Property**, the taxpayer begins manufacturing, constructing, or producing the property after December 31, 2007, and before January 1, 2013; and



# What is “Qualified Property”?

- 4. is placed in service by the taxpayer before January 1, 2013, or, in the case of “Certain Aircraft” or “Property Having Long Production Periods”, before January 1, 2014.



# What is “Original Use”?

→ “Original Use” means the first use to which the property is put, whether or not that use corresponds to the use of the property by the taxpayer.



# 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.
- ➔ In determining whether a contract limits damages, the fact that there may be little or no damages because the contract price does not significantly differ from fair market value will not be taken into account.



# What are “Certain Aircraft”?

- “Certain Aircraft” are aircraft which:
- are not “Transportation Property”;
  - 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 costs exceeding \$200,000.



# 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.



# What is “Self-Constructed Property”?

→ “Self Constructed Property” includes property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract that is entered into prior to the manufacture, construction, or production of the property for use by the taxpayer in its trade or business (or for its production of income).



# Self-Constructed Property

→ Treasury Regulations provide an example indicating that newly manufactured aircraft purchased from the manufacturer would be considered self-constructed property where a buyer entered into a contract to purchase the aircraft prior to commencement of construction of the aircraft.



# Self-Constructed Property

- Manufacture, construction, or production of property begins when physical work of a significant nature begins.
- Physical work does not include preliminary activities such as planning or designing, securing financing, exploring, or researching.



# Self-Constructed Property Safe Harbor

- Taxpayers generally may elect to determine when physical work of a significant nature begins in accordance with a Safe Harbor. However, when property (e.g. an aircraft) is manufactured, constructed, or produced for the taxpayer by another person, the safe harbor test must be satisfied by the taxpayer.
- Under the Safe Harbor, physical work of a significant nature will not be considered to begin before the taxpayer incurs (in the case of an accrual basis taxpayer) or pays (in the case of a cash basis taxpayer) more than 10 percent of the total cost of the property.



## Self-Constructed Property Safe Harbor

→ For example, if an aircraft is to be constructed by an OEM for a cash basis taxpayer for the total cost of \$20,000,000, construction should be deemed to begin for purposes of this safe harbor when the taxpayer has paid more than 10 percent (\$2,000,000) of the total cost of the aircraft.



## Self-Constructed Property Safe Harbor

→ A taxpayer chooses to apply the safe harbor by making a notation on the income tax return for the placed-in-service year indicating the date when physical work of a significant nature began consistent with the safe harbor.



# What is “Property Having Long Production Periods”?

- ➔ In order for property placed in service in 2013 (other than “Certain Aircraft”) to qualify for Bonus Depreciation, the property must satisfy each of the following four tests:
- (1) the property must meet all the requirements of “Qualified Property” discussed above;
  - (2) the property must either have a recovery period of at least 10 years or be “Transportation Property”;



# What is “Property Having Long Production Periods”?

- (3) the property must be subject to IRC Section 263(A) (which applies to real or tangible personal property produced by the taxpayer); and
- (4) 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.



# What is “Property Having Long Production Periods”?

- ➔ This last requirement will eliminate many business-class aircraft that are “Transportation Property” and are placed in service in 2013 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.



## What is “Property Having Long Production Periods”?

→ If a “Transportation Property” aircraft placed in service in 2013 qualifies as “Property Having a Long Production Period”, as previously stated, 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, 2013.



# What is “Property Having Long Production Periods”?

→ How do you calculate that portion of the adjusted basis of such aircraft attributable to manufacture, construction, or production before January 1, 2013?



# What is “Property Having Long Production Periods”?

- Neither the statute, nor the regulations answer the question. However, 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 employed to determine what portion of such costs are attributable to production before January 1, 2013.
- Consistent with Section 46(d)(3), the amounts that would be attributable to production before January 1, 2013, would likely be the lesser of (i) the amounts paid before January 1, 2013, or (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 before January 1, 2013.



# Summary

## Acquired/Placed in Service

Type of Property	Jan 1, 2008 – Sep 8, 2010	Sep 9, 2010 – Dec 31, 2011	Jan 1, 2012 – Dec 31, 2012	Jan 1, 2013 – Dec 31, 2013
<b>Certain Aircraft</b>	50% of Cost	100% of Cost	50% or 100% of Cost (See Note)	50% of Cost
<b>Long Production Times</b>	50% of Cost	100% of Cost	50% or 100% of Cost (See Note)	50% of Pre-2013 Production
<b>Other Qualified Property</b>	50% of Cost	100% of Cost	50% of Cost	None

Note:

Property acquired Sep 9, 2010 - Dec 31, 2011, but placed in service in 2012, qualifies for 100%.

Property acquired and placed in service in 2012, qualifies for 50%



# Special Rules; Predominant Use

Bonus depreciation does not apply to aircraft used predominately outside the United States.

→ 50% test

→ Some degree of frequency test



# 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

- ➔ 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 (apply applicable convention).



# 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.



# Flipping an OEM Contract

- A Treasury Regulation example indicates that where a taxpayer enters into a written binding contract prior to January 1, 2008 (September 11, 2001 in the example), and then subsequently transferred the rights to own and use the property to another unrelated taxpayer, the transferee taxpayer can qualify for bonus depreciation.
- The use of the phrase “transferred the rights to own and use” in the Treasury Regulations is ambiguous, and it is not clear whether the phrase implies an assignment of the original OEM agreement, or a back-to-back title transfer of a new aircraft without an assignment of the OEM agreement, or both.



## Special Rules: OEM Demonstrators

→ New aircraft used by a manufacturer or dealer for demonstrator purposes prior to sale to a customer should qualify. In such situations, the “Original Use” of the aircraft is considered to be by the taxpayer and not by the dealer or manufacturer.



# Special Rules: Fractional Aircraft

→ If, in the ordinary course of its business, a taxpayer sells fractional interests in property to third parties unrelated to the taxpayer, each first fractional owner of the property is considered as the original user of its proportionate share of the property.



# Special Rules: Rebuilt Aircraft

- Rebuilt and reconditioned aircraft do not qualify.
- The cost of new upgrades and improvements (e.g., new engines and new avionics) purchased by a taxpayer for an aircraft the taxpayer already owns can qualify; but if the taxpayer purchases a used aircraft after the upgrades and improvements have been made, the aircraft will be considered rebuilt or reconditioned and no part of the total acquisition cost will qualify.



# Special Rules: Sale-Leasebacks

- ➔ If an original buyer places an aircraft in service after December 31, 2007, and within three months after the aircraft was placed in service, the original buyer sells the aircraft to a leasing company and leases it back from the leasing company, the leasing company may treat the aircraft as originally placed in service not earlier than the date on which the leasing company leased the aircraft back to the original buyer.



## Special Rules: Syndications

→ If a leased aircraft is placed in service after December 31, 2007, and within three months after the aircraft was placed in service the lessor sells the aircraft, but the lessee does not change, the aircraft will be treated as originally placed in service not earlier than the date of the sale.



# MACRS/ADS Depreciation and IRC 280F



# Depreciation

→ The Tax Code allows a deduction for exhaustion, ordinary wear and tear and obsolescence of property used in a trade or business or held for the production of income. This deduction is known as “depreciation”.



# Depreciation

## Methods:

→ MACRS: double-declining balance method accelerates/front-loads deductions providing greater deduction in the early years of the depreciation schedule, and reduced deductions in the later years

→ ADS: straight-line method provided a level depreciation level over all years of the depreciation schedule



# Depreciation

- Depreciation method and schedule determined by types of use (i.e., commercial vs. non-commercial) and percentage of “**Qualified Business Use**”.
- **Qualified Business Use** is use in a trade or business of the taxpayer.



# Predominant Use Within vs. Outside United States

MARCS depreciation does not apply to aircraft used predominately outside the United States.

- 50% test
- Some degree of frequency test



# Depreciation Deductions

## The Applicable Recovery Period

### → Asset Class 00.21:

- Applies to 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”).
- Five Year Recovery Period (MACRS).
- Six Year Recovery Period (Straight-Line - ADS).



## ASSET CLASS 00.21 – APPLICABLE PERCENTAGES (Half-Year Convention)

<u>Year</u>	<u>Percentage Deduction</u>	
	5 Year Property	6 Year Property
1	20.00%	8.333%
2	32.00%	16.667%
3	19.20%	16.667%
4	11.52%	16.667%
5	11.52%	16.667%
6	5.76%	16.667%
7	-	8.333%



# Depreciation Deductions

## The Applicable Recovery Period

### → Asset Class 45.0:

- Air Transport: Includes assets (except helicopters) used in commercial and contract carrying of passengers and freight by air, (e.g., Part 135 charter aircraft).
- Seven Year Recovery Period (MACRS).
- Twelve Year Recovery Period (Straight-Line - ADS).



# ASSET CLASS 45.0 – APPLICABLE PERCENTAGES (Half-Year Convention)

Year	<u>Percentage Deduction</u>	
	7 Year Property	12 Year Property
1	14.29%	4.167%
2	24.49%	8.333%
3	17.49%	8.333%
4	12.49%	8.333%
5	8.93%	8.333%
6	8.92%	8.333%
7	8.93%	8.333%
8	4.46%	8.333%
9-12	-	8.333%
13	-	4.167%



# Depreciation Deductions

## The Applicable Recovery Period

- If an aircraft is used part of the time in commercial carrying of passengers and freight (i.e., asset class 45.0), and part of the time for other purposes (i.e., asset class 00.21), the aircraft should be depreciated according to its **primary** use.
- A change in the primary use of the aircraft after the year in which the aircraft was placed in service requires a change in the depreciation method and/or recovery period.



# Qualified Business Use

## → 50% Test:

- IRC 280F provides that to qualify for MACRS, more than 50% of the use of the aircraft must be Qualified Business Use.

## → 25% Test:

- IRC 280F further provides that three categories of uses only qualify as “Qualified Business Use” for purposes of the 50% test if all other Qualified Business Uses comprise at least 25% of the total use.



# Qualified Business Use

- The three categories of uses excluded for purposes of the 25% test are::
- Leasing of 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 to any person who owns 5% or more of the company, or to any related person.
  - 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).



# Qualified Business Use

→ CAUTION!

→ TAM 200945037:

- IRS interpreted 280F to exclude all use of an aircraft that is leased to a “related person” (defined to include related business entities) from being used to meet the 25% test regardless of whether such use was for business or personal purposes.



# Qualified Business Use

- The 25% and 50% use tests must be met during every taxable year that the aircraft is in service.
- If an aircraft depreciated under MACRS or Bonus Depreciation rules during any taxable year fails the 50% test in a subsequent year, the taxpayer must recapture prior depreciation to the extent that depreciation deductions taken during prior years exceed the deductions that would have been allowed under the ADS system.



# Closing Remarks



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