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To: jeffrey E.
Subject: FW: Tax Bill Aircraft Provisions - Bonus Depreciation, Like kind exchanges, and Safety Concerns

FYI

From: Wimer, Ruth [REDACTED]
Sent: Wednesday, December 20, 2017 4:17 PM
To: Wimer, Ruth <[REDACTED]>
Subject: Tax Bill Aircraft Provisions - Bonus Depreciation, Like kind exchanges, and Safety Concerns

Below is a summary with 100% bonus depreciation (even for used aircraft) and the denial of like-kind exchanges most noteworthy. Observation: Having an Independent Security Study in place may meet the "safety concern" requirement to keep commuting expenses deductible. Best, Ruth (202) 282-5358

Tax Reform Highlights for Business Aviation

100-Percent Expensing (Bonus Depreciation)

A 2015 Act extended bonus depreciation for qualified property (including commercial and non-commercial aircraft used in a trade or business with a recovery period of 20 years or less) through 2019, with a phase-down over time from 50 percent to 30 percent.

Under the Tax Bill, however, the current law would be amended to provide for 100-percent expensing, which will allow taxpayers to immediately write off the cost of aircraft acquired and placed in service after Sept. 27, 2017 and before Jan. 1, 2023 (Jan. 1, 2024 for longer production period property and certain aircraft). Through the efforts of NBAA and a coalition of general aviation groups, the new law would permit 100 percent expensing by the taxpayer for both factory-new and pre-owned aircraft so long as it is the taxpayer's first use of the aircraft.

For tax years after 2022, the bill provides for a phase down of bonus depreciation in increments of 20 percent each year for qualified aircraft acquired and placed in service before Jan. 1, 2027 (Jan. 1= 2028 for longer production period property and certain aircraft).

Like-Kind Exchanges

Under current law, when property (including business=aircraft) held for productive use in the taxpayer's trade or business or for investment is exchanged for property that is "like-kind," a special rule under Internal Revenue Code (IRC) § 1031 provides that no gain or loss is recognized to the extent that the replacement property is also held for productive use in a trade or business or for investment purposes.

The Tax Bill modifies this special rule only to allow for like-kind exchanges of real property. As a result, taxpayers will no longer be eligible to defer taxable gain on the sale of aircraft via a like-kind exchange, and the gain would be subject to recapture for tax purposes. This provision is effective for transfers after 2017, and is a permanent repeal of application of IRC § 1031 rules to exchanges involving aircraft and other tangible personal property.

However, a transition rule preserves like-kind exchanges of personal property if the taxpayer has either disposed of the relinquished property or acquired the replacement property on or before Dec. 31, 2017. Further, 100 percent expensing of new and used property helps to compensate for the repeal of like-kind exchanges for tangible personal property, though unlike such repeal and as noted above, 100 percent expensing is scheduled to expire in 2023/2024 with an additional phase down until 2027/2028.

Prohibition on Deduction of Employees' Commuting Expenses

The Tax Bill prohibits employers from deducting the cost of providing transportation to employees to commute between the employee's residence and place of employment unless provided for the safety of the employee. It is unclear whether this new provision would allow the deduction of commuting expenses included in income, and if so, whether such deduction is limited to only the actual amount of the expense included in income.

Disallowance of Travel Expenses "Directly Related" to Business

The Tax Bill makes far-reaching changes to the basic deduction disallowance rules for business entertainment which could affect many aircraft owners. Historically, the general rule of IRC § 274 disallowed all entertainment expenses (assuming no exception applied) unless directly related or associated with the active conduct of the business. Therefore, the 100 percent deduction disallowance did not apply to the entertainment of business customers, prospective clients, company retreats and other entertainment events where business was conducted immediately before, during or after

the entertainment, or the entertainment was clearly associated with a business goal unrelated to providing the entertainment such as the opening of a new business location. Beginning in 2018, the Tax Bill disallows all entertainment expenditures, regardless of whether they are directly related to a business goal.

Repeal of Miscellaneous Itemized Deductions, Including Employee Business Expenses

The Tax Bill eliminates miscellaneous itemized deductions, including employee business expenses beginning in 2018 and before January 1, 2026. Prior to the amendment, employees could deduct expenses incurred in performing their work, subject to the limitation that such expenses (along with other miscellaneous itemized deductions) were only deductible to the extent that the total of such expenses exceeded 2 percent of adjusted gross income.

The 2% floor was a simplification measure in the 1986 Tax Act under which very few taxpayers needed actually to calculate their miscellaneous itemized deductions. For the same reason, eliminating the deduction is expected to affect relatively few taxpayers. However, the effect on the taxpayers whose adjusted gross income is not extremely high and who are currently able to deduct their aircraft expenses as employee business expenses to the extent they exceed the 2-percent floor could be substantial. Such taxpayers may want to consider restructuring their compensation arrangements into accountable plan arrangements, which are not affected by the Tax Bill.

Transportation Excise Tax Does Not Apply to Owner Flights on Managed Aircraft

The Tax Bill also amends IRC § 4261 by adding a new subsection to clarify that owner flights on managed aircraft are not subject to Federal Transportation Excise Tax (FET) ticket tax, but rather are subject to the non-commercial fuel tax. This issue has been the subject of controversy for more than 60 years, and this amendment clarifies the law consistent with the understanding of most people in the industry.

The FET exception applies to payments by the aircraft owner (or lessee) for aircraft management services related to maintenance support or flights on the aircraft. The exception does not actually require that the owner be on the flight or that the flight be on the business of the owner, but only that the owner (or lessee) pay for the aircraft management services.

“Aircraft management services” are defined broadly, and no distinction is drawn between payments for aircraft management services versus payments for transportation services. It is sufficient that the payments by the owner (or lessee) ultimately cover the aircraft functions identified in the statute as aircraft management services. Since the only requirement is that the payments for aircraft management services be made by the owner or lessee, there appears to be no need to analyze whether or not the management company exercises possession, command and control of the aircraft.

The amendment includes new IRC § 4261(e)(5)(D) that appears to provide that if a portion of any payment is for taxable transportation but such portion is not paid for "aircraft management services," then such portion of the payment is taxable. While this provision could cause confusion, we believe it is intended to mean that when a payment includes a taxable portion (such as payment for a flight on an aircraft not owned by the payor) and a nontaxable portion (such as payment with respect to a flight on an aircraft owned by the payor), only the taxable portion is subject to FET.

The FET exception only applies with respect to flights paid for by the owner or lessee. Accordingly, if an owner leases the aircraft to a management company, and an affiliate of the owner pays the management company for the flight, the exception would not appear to apply. In contrast, if the aircraft owner leases the aircraft to its affiliate and the affiliate (being a lessee) pays the management company for services related to the flight, then the exception would apply.

Entities that may be disregarded for income tax purposes (such as single-member LLCs, qualified subchapter S subsidiaries and grantor trusts) are respected as separate entities for FET purposes and can expect to be respected for purposes of this exception. For example, if a company owns a single-member LLC which owns an aircraft, the FET exception would not appear to apply to payments by the company to a management company to manage the aircraft. However, if the LLC leases the aircraft to the company, then the company's payments should be covered by the exception.

The FET exception will not apply to payments by a lessee that is leasing the aircraft from the management company under a lease with a term of thirty-one (31) days or less. This is intended to prevent the exception from applying to one-off customers of a charter company who structure their charters as wet leases. Such a wet lease structure may also be problematic from an FAA regulatory perspective.

The provision is effective for payments after the date of enactment, which could be as early as Dec. 22, 2017. While the provision will not be directly applicable to owner flights prior to this date, we understand that the IRS has recently been (correctly) interpreting current law to not impose FET on management fees with respect to owner flights and we would hope that this provision would reinforce that approach.

Acknowledgments


This article was written by NBAA Tax Committee members John B. Hoover, Cooley LLP, and Ruth Wimer, Winston & Strawn LLP, with thanks to Richard C. Farley, Jr., PwC, and Jeff Wieand, Boston Jet Search. Learn more about the NBAA Tax Committee.

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