

CLIENT UPDATE



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BONUS DEPRECIATION EXTENDED FOR NEW AIRCRAFT PURCHASERS

Tax law changes enacted in the first few days of January 2013 include some good news for aircraft buyers. Bonus Depreciation benefits have been extended. This article will explore and summarize Bonus Depreciation and will examine some practical considerations for taking advantage of this benefit. Sadly, 100% Bonus Depreciation is no longer available. However, many deliveries of new aircraft in 2013 will qualify for 50% Bonus Depreciation. If certain additional qualifying conditions are met, aircraft placed in service in 2014 may also qualify for 50% Bonus Depreciation treatment.

What then is Bonus Depreciation? Briefly stated, for new aircraft and other assets placed in service in 2013 as well as for cer-

tain other aircraft placed in service in 2014, up to 50% of the cost of such property may be deducted in the year the property is acquired. The remaining 50% of the cost or "basis" remains eligible for depreciation in the year of acquisition and future tax years according to normal depreciation rules.

In order to be Bonus Depreciation eligible, an asset must be "MACRS property." This means that property used less than 50% of the time for business purposes and property used predominantly outside the United States will not be eligible for Bonus Depreciation. In addition, in order for an asset to be eligible for Bonus Depreciation, the asset must be "new." Pre-owned aircraft do not qualify.

EXAMPLE

To illustrate the benefit of 50% Bonus Depreciation, assume that Taxpayer A acquires a new aircraft for \$10,000,000. Without Bonus Depreciation, Taxpayer A's depreciation schedule for the aircraft will be as follows:¹

FIVE-YEAR MACRS PROPERTY WITHOUT 50% BONUS DEPRECIATION.

YEAR	PERCENTAGE DEDUCTION		DEPRECIABLE BASIS	=	DEPRECIATION AMOUNT	TAX SAVINGS (@ 34% RATE)
1	20.00	x	\$10,000,000	=	\$2,000,000	\$680,000
2	32.00	x	\$10,000,000	=	\$3,200,000	\$1,088,000
3	19.20	x	\$10,000,000	=	\$1,920,000	\$652,000
4	11.52	x	\$10,000,000	=	\$1,152,000	\$391,680
5	11.52	x	\$10,000,000	=	\$1,152,000	\$391,680
6	5.76	x	\$10,000,000	=	\$576,000	\$195,840
Totals:	100.00				\$10,000,000	\$3,400,000

¹The Tables provided illustrate the benefit of depreciation and 50% Bonus Depreciation for a "non-commercial" aircraft depreciated on a five-year schedule. "Commercial" aircraft, generally including aircraft used predominantly in charter service, will be depreciated over a longer seven-year schedule. The levels of depreciation in each year will be lower for seven-year property, but the impact of 50% Bonus Depreciation will be the same. Any qualifying aircraft will remain eligible for depreciation benefits equal to 50% of the cost of the aircraft in the year it is placed in service.

Now assume that Taxpayer A acquires the same \$10,000,000 aircraft but that the aircraft is eligible for 50% Bonus Depreciation. Taxpayer A's depreciation benefits will be as follows:

FIVE-YEAR MACRS PROPERTY WITH 50% BONUS DEPRECIATION.

YEAR	PERCENTAGE DEDUCTION		DEPRECIABLE BASIS		DEPRECIATION AMOUNT	TAX SAVINGS (@ 34% RATE)
Bonus (Yr. 1)	50.00	x	\$10,000,000	=	\$5,000,000	\$1,700,000
1	20.00	x	\$5,000,000	=	\$1,000,000	\$340,000
2	32.00	x	\$5,000,000	=	\$1,600,000	\$544,000
3	19.20	x	\$5,000,000	=	\$960,000	\$326,000
4	11.52	x	\$5,000,000	=	\$576,000	\$195,840
5	11.52	x	\$5,000,000	=	\$576,000	\$195,840
6	5.76	x	\$5,000,000	=	\$288,000	\$97,920
Totals:	100.00				\$10,000,000	\$3,400,000

Note should be taken of the fact that although the placed in service date is extended through 2014 for “transportation property” and “certain aircraft,” the other Bonus Depreciation eligibility requirements must still be satisfied.

As the tables illustrate, 100% Bonus Depreciation provides dramatic tax savings in the year that an asset is acquired. The *cumulative* depreciation benefits and tax savings over the depreciable life of the aircraft remain the same (i.e., 100% of the acquisition cost and \$3,400,000, respectively). Bonus Depreciation accelerates the benefits and yields greater time-value returns but results in lower levels of depreciation benefits in the following tax years.

TIMING/PLACED IN SERVICE

Let's now turn our attention to what makes an aircraft or other asset “qualifying property” for Bonus Depreciation purposes. The Internal Revenue Code sets forth specific criteria for “qualifying property.”

Aircraft whose *original use* commences with the taxpayer in 2013 are eligible for 50% Bonus Depreciation. In addition, the aircraft must be “placed in service” prior to the end of 2013. There are some limited extensions of the 2013 placed in service date through 2014 for “transportation property” and “certain aircraft.” Furthermore, only aircraft for which there was “no written binding contract for the acquisition ... in effect before January 1, 2008” or for which “a written binding contract ... was entered into” prior to January 1, 2014 will qualify for 50% Bonus Depreciation.

In prior years, long delivery backlogs made it extremely difficult to find an aircraft which could meet both the contract formation and placed in service requirements. However, the current economic slowdown has freed up many delivery positions. As a practical matter, it is possi-

ble to enter into a contract in 2013 and still meet the relatively short placed in service deadlines.

The placed in service date requirement has been extended through 2014 for two types of aircraft, “*transportation property*” and “*certain aircraft*.” The statute and regulations do not provide much guidance as to what constitutes “transportation property” other than to say that “transportation property” includes tangible personal property used in the trade or business of transporting persons or property. Presumably, this would include an aircraft that is used predominantly for charter missions. It is not likely that an aircraft used less than half the time in charter service will qualify. Although the placed in service date is extended through 2014 for transportation property, the 50% Bonus Depreciation benefit is limited “only to the extent of the adjusted basis attributable to manufacture, construction or production before January 1, 2014.” Thus, a taxpayer’s basis in transportation property will be limited to the lesser of the amounts paid by the taxpayer through 2013 or the percentage of production completed by the manufacturer as of December 31, 2013.

The placed in service requirement is also extended through 2014 for “certain aircraft.” “Certain aircraft” are defined as aircraft which are not “transportation property,” which cost more than \$200,000 and have an estimated production period exceeding four months. Virtually all jets and turboprops meet these additional criteria. In addition, at the time of contract for purchase, the purchaser is required to make a nonrefundable deposit of at least the lesser of 10% of the cost or \$100,000. Aircraft which meet all these criteria are deemed to be “certain aircraft” for which the extended placed in service date applies.

Note should be taken of the fact that although the placed in service date is extended through 2014 for “transportation property” and “certain aircraft,” the other Bonus Depreciation eligibility requirements must still be satisfied. Thus, for example, the “original use” and contract entry rules must still be satisfied.

Purchasers who entered into their delivery contracts as far back as 2008 for aircraft which deliver in 2013 are now 50% Bonus Depreciation eligible. In addition, aircraft which qualify as either “transportation property” or “certain aircraft” which are placed in service in 2014 may also

qualify for 50% Bonus Depreciation. Prior to the most recent tax law changes, these aircraft would not have qualified for 50% Bonus Depreciation. For example, prior to the current extensions of Bonus Depreciation most aircraft contracted for in 2008 and placed in service in 2013 would not have qualified for 50% Bonus Depreciation. With the extensions of placed in service dates, these aircraft will now qualify for 50% Bonus Depreciation. Purchasers of aircraft qualifying under the “transportation property” or “certain aircraft” rules and acquired pursuant to contracts entered into in prior years should review their situations as their aircraft may now be eligible for 50% Bonus Depreciation in either 2013 or 2014.

FRACTIONAL AIRCRAFT, RELATED EQUIPMENT AND UPGRADES

Bonus Depreciation may also prove a valuable tool for aircraft owners who are acquiring assets other than whole aircraft. Regulations promulgated by the Service specifically state that fractional aircraft interests are eligible for Bonus Depreciation. The current availability of fractional interest inventory makes it relatively easy to acquire a qualifying fractional interest. However, in order for a fractional interest to qualify it must be a “new share,” that is, there may be no previous owner of the share other than the fractional program itself. In addition, Bonus Depreciation may prove valuable for taxpayers making capital acquisitions related to their aircraft, such as tugs, engine replacements or major avionics or interior upgrades.

Bonus Depreciation accelerates the benefits and yields greater time-value returns but results in lower levels of depreciation benefits in the following tax years.

FINANCIAL TRANSACTIONS

Sale leaseback and syndication transactions continue to enjoy favorable treatment provided by the regulations. An aircraft originally placed in service by an end user, sold to a leasing company and leased back to the end user within three months after the original placed in service date remains eligible for Bonus Depreciation. Note that as the leasing company is now the “owner” of the leased aircraft, the leasing company, not the lessee/operator, is entitled to the benefits of Bonus Depreciation. An aircraft sold from one leasing company to another within three months of the original placed in service date remains eligible for Bonus Depreciation in the hands of the second leasing company. In addition, it is possible to “stack” sale-leaseback and syndication transactions so that the syndication transaction may occur up to six months after the original acquisition of the aircraft.

CONCLUSION

Changes in the Bonus Depreciation eligibility rules provide some significant benefits for purchasers of new business aircraft. In order to qualify for 50% Bonus Depreciation, aircraft which are not “certain aircraft” or “transportation property” must be placed in service prior to the end of 2013. Aircraft which qualify as either “certain aircraft” or “transportation property” must be placed in service prior to the end of 2014 in order to receive 50% Bonus Depreciation.

This article has highlighted some of the strategies for qualifying for Bonus on a new aircraft purchase. The reader is cautioned that this article is not intended to be more than an introduction to the topic. Anyone considering taking Bonus Depreciation benefits for a new aircraft should not only read the law and applicable Regulations, but should also retain independent legal, tax and accounting advice to determine if their aircraft is eligible for Bonus Depreciation and to properly structure their acquisition.²

²Please Note: Bonus Depreciation has previously been available in years 2003 through 2012. Although the basic principles of Bonus Depreciation in prior years are similar to the current Bonus Depreciation rules, the eligible dates for “original use,” “placed in service” and contract formation vary from year to year. In addition, the percentage of the acquisition price of an aircraft eligible for Bonus Depreciation has fluctuated between 30% and 100% in prior years. Please consult the author’s prior articles for discussions of Bonus Depreciation in previous years.

This article is being provided for general information and should not be construed as legal advice or legal opinion on any specific facts or circumstances. You are urged to consult your attorney or other advisors concerning your own situation and for any specific legal questions you may have.

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