



Private Aviation Seminar Series: California and IRS Aircraft Tax Issues

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Agenda

- Review Prior Sessions
- State Tax Issues
 - Sales and Use Tax
 - Property Tax
- Federal Tax
 - Deductions/ Depreciation
 - Personal Use
- Q&A



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Accessing Private Aviation

- Charter
 - One time transportation
- Jet Cards
 - 25 or 50 hour prepaid blocks
 - Part 135
- Fractional Ownership
 - Undivided interest
 - 5 year contract
 - Part 91 or 135
- Whole Ownership
 - You own, operate and control your aircraft
 - You control hiring crew and maintenance personnel



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Making Informed Decision

- Financing Considerations
 - Evaluate the cost to purchase AND operate
 - Lease vs. Buy
- Transportation Needs
 - Typical Mission
 - Desired Features
- Market Research
- Aircraft Selection
- Technical Analysis



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Purchasing an Aircraft

- Select Aircraft and Make Offer
- Visual Inspection/ Records Review
- Negotiate Purchase Agreement
- Confirm Aircraft Ownership and Operation and Tax Strategy
- Technical Inspection
- Correction of Discrepancies
- Delivery and Closing



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Ownership and Operating Plans

- Aircraft Ownership Structure will depend on:
 - Operational Factors
 - Tax Factors
 - Liability Factors
- Operating Plan Considers:
 - Tax Advantages
 - Liability Exposure
 - FAA Compliance



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Sales and Use Tax

- Sales Tax Explained
 - “Sale” takes place in California
- Use Tax Explained
 - Item purchased for “use, storage or consumption” in California
- Careful planning is required

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Exemptions

- Not Purchased for Use in CA
- Interstate Commerce
- Charter or Common Carrier



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Not Purchased for Use in CA

- Currently 90 day test
- Take delivery outside of California
- Keep and use outside of California for 90 days
- Maintain documentation to prove
 - Hangar receipts
 - Flight logs
 - Fuel receipts
- Likely to change back to 12 month test



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Interstate Commerce

- Six month test, more than 50% hours flown in interstate flights for business
- Take delivery outside of California
- “Functional Use” outside of California prior to first entry
- Maintain documentation to prove
 - Flight logs
 - Fuel receipts
 - Business records



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Charter

- Twelve month test, more than 50% hours flown under Part 135 with passengers or property on board
- Minimum Revenue Required
 - Unrelated third parties
- Deadheads do not count, other types of flights do not count
- Maintain documentation to prove
 - Flight logs, Charter Invoices, Tax Returns & Other
- FET


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Property Tax


- Application of property tax among states and counties
- Exemptions
 - Held for sale or lease
- Appeals strategies
 - Over assessment of hull value based on fair value
 - Certain exclusions available to common carriers
- Apportionment

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Federal Tax Issues

- Entity & Structure
- Depreciation in General
- Depreciation Methods
- Personal Use




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Entity & Structure

- Must be owned or leased by a business entity
- Operation of aircraft must be “incidental” to core business
- Operating expenses must be ordinary & necessary
 - Ordinary
 - Necessary
- Personal Use – certain types may be deductible

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Depreciation in General

- Placed in service
- Listed Property Rules
 - Business Use must be 50% or more
- Beware Special Purpose Entities – “flight dept company”
- Recapture provisions on sale

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Depreciation Methods

- MACRS 5-year recovery, Part 91 usage
 - depreciation taken over 6 years
 - 20%, 32%, 19.2%, 11.52%, 11.52%, 5.76%
- MACRS 7-year recovery, Part 135 usage
 - depreciation taken over 8 years
 - 14.29%, 24.49%, 17.49%, 12.49%, 8.93%, 8.92%, 8.93%, 4.46%
- MACRS Conventions



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Personal Use Issues

- Any use not incidental to core business of company
 - Routine personal travel, unrelated business purpose travel, or entertainment or recreational travel
- Two acceptable methods of handling personal use.
 - Timeshare agreement (brief) - form of a dry lease
 - Treat personal usage as fringe benefit
- Accounting Issues
 - Compensation
 - Disallowance of deduction


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Personal Use Illustration

- Characterization of each flight segment:
 - Business
 - Personal Business
 - Personal Entertainment


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SIFL Rules


- Fringe benefits have a compensation component or fringe benefit value determined under the SIFL rules
 - General Concepts: Fair value charter method and SIFL method
 - Compensation must be reported to IRS and SSA on Form W-2 or Form 1099
 - Calculation methodology: (Statute miles x rate + charge) x MTOW factor
 - Complexities: Control vs non-control employees
 - Resources: NBAA Handbook available on web at www.nbaa.org

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Is the cost of personal use tax deductible?

- Is the cost of personal use tax deductible?
 - Old law, Sutherland Lumber
 - American Jobs Creation Act (Oct 2004)
 - Notice 2005-45 (June 2005)
 - Proposed Regulations (June 2007)
- Definition of fully allocated costs
- Occupied Seat Hour method, Trip method
- Recordkeeping requirements
- Recent developments:
 - NBAA comments to IRS
 - NBAA "Charter Safe Harbor" proposal



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Depreciation Example

- Comparison of Bonus Depreciation and Existing Law
- Aircraft Purchase Price= \$10,000,000
- Placed in Service= 2/1/08
- Part 91

| Depreciation in Year | Existing Law | Proposal |
|----------------------|--------------|-----------|
| 1 | 2,000,000 | 6,000,000 |
| 2 | 3,200,000 | 1,600,000 |
| 3 | 1,920,000 | 960,000 |
| 4 | 1,152,000 | 576,000 |
| 5 | 1,152,000 | 576,000 |
| 6 | 576,000 | 288,000 |

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Depreciation Example

- Comparison of Bonus Depreciation and Existing Law
- Aircraft Purchase Price= \$10,000,000
- Placed in Service= 2/1/08
- Part 135

| Depreciation in Year | Existing Law | Proposal |
|----------------------|--------------|-----------|
| 1 | 1,429,000 | 5,714,500 |
| 2 | 2,449,000 | 1,224,500 |
| 3 | 1,749,000 | 864,500 |
| 4 | 1,249,000 | 624,500 |
| 5 | 893,000 | 446,500 |
| 6 | 892,000 | 446,000 |
| 7 | 893,000 | 446,500 |
| 8 | 446,000 | 223,000 |

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Bonus Depreciation

- 50% in year of Purchase if placed in service before 1/1/09
- Likely effective after 1/31/08
- Contract for Purchase
 - 10% of cost or \$100,000 non-refundable deposit
 - Estimated production period > 4 months/ cost >\$200,000



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Upcoming Seminars

- 3/5/2008 - Financing the Aircraft Purchase or Improvements - How to Get the Best Results
- 4/17/2008 - Estate Planning With Respect to Your Corporate Aircraft
- 5/22/2008 - Aircraft Safety and Risk Management

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The slide features a blue background with a white border. In the top right corner, there is a small image of an airplane's tail. The text "Q&A" is centered in a dark blue box. Below it, the text "Thank you for attending!" is centered. At the bottom left, there are two small images: one of an airplane's cockpit and another of an airplane in flight. The bottom right corner contains the logos for "LUCE FORWARD" (ATTORNEYS AT LAW - FOUNDED 1973) and "U.S. TRUST" (Bank of America Private Wealth Management). Below these logos is the name "GEORGE P. RICE" and his credentials: "CERTIFIED PUBLIC ACCOUNTANT" and "AVIATION & MARINE SPECIALIST". At the very bottom, there is a small copyright notice: "© 2008 Luce, Forward, Hamilton & Scripps LLP. All rights reserved."
