# "Let Uncle Sam Pay For Your New Plane"

Aviation tax expert and CPA, Daniel Cheung, explains how to maximize income tax savings AND minimize sales and use tax for aircraft operators. (11/11/17)

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James Kerr: Hello, everyone. This is James with Aviat Aircraft and I want to welcome you to today's presentation. We have Daniel Cheung again from Aviation Tax Consultants. He's going to give us the latest and the most insightful information we need to know as owners and operators of aircraft. Daniel, thank you so much for joining us today.

Daniel Cheung: Thank you, James.

[00:00:30]
James Kerr: And before we start, I want to make sure everyone can hear us loud and clear. You should have a control panel, there's a section for questions. There's also a section for live chat. Just give us a quick message and let us know that you can hear us loud and clear, and that you can see our first slide.

Okay, good. We're good to-go. Daniel, take it away.

[00:01:00]
Daniel Cheung: Good morning. Thank you, James for the invitation again. We did this last year and hopefully it helps some of you guys out there looking to buy a plane or understanding the tax benefits available on buying a business use airplane in terms of how it can help with tax savings, tax deductions and so forth.

[00:01:30] Just a very brief background about our company. I started ATC back in 2003, so this is our 15th year working in the industry. This is all we do now, we don't do any other consulting, so that's all we talk about every day. My office is in Columbus, Indiana, just south of Indianapolis. I came over from Hong Kong. Born and raised in Hong Kong, went to high school in Mississippi and then went to IU. Met my wife, an [00:02:00] Indiana gal, so I’ve been in Indiana for the last 30 some years. Married, two boys, I'm a naturalized [inaudible 00:02:10] and U.S. citizen, so. But anyway, the basic topics, the two main topics I'll be discussing with the income tax benefits in planning opportunities and also sales and used tax planning opportunities. Understand we have people from all over the country, so some of the comments are a little more general in nature in terms of sales and use tax.

[00:02:30]

But in terms of federal income tax, who can write up an airplane, that's obviously the most important question. Our most common client profile is a small business owner or some employee with a consulting practice or really goes to many, many different professions. The key is we need some sort of justification to write up an [00:03:00] airplane, just like anything else you take a deduction on. I always just simply say it's a smell test.

For example, a lot of prospects have called me and they will say, maybe a medical doctor in Indiana. One medical office for patients where you live, is impossible to justify a plane. However, if there is an opportunity to maybe set up a remote office, maybe in a rural area of a state. Now, you have two offices, you can fly between [00:03:30] the two offices. Now, all of a sudden we have a justification. If your employment status as a W2 employee with a big company or you're retired, again, obviously those situations the tax code is not very friendly unfortunately, in terms of tax deductions when you are an employee of another business.

[00:04:00] Who can write off an airplane? We have a tax consulting company, we fly a small piston airplane and we use the airplane to go see clients, go to trade shows and what not. That's the business use of our airplane, for example. And again, it doesn't matter what kind of profession you are, you know in this day and age you can do a [00:04:30] lot of work online and internet and so forth, but the tax code does not forbid from flying your own airplane to conduct business. Again, if you can utilize an airplane to grow and expand your business that would be a perfect situation to justify writing off an airplane.

We look at the airplane as just like any other business tool you have for your [00:05:00] business, no different than your car, or laptop, or any other tools. The airplane allows you to become more efficiently run business and or to grow your business - to expand to other geographical locations. So those are the typical tax situations that we deal with in terms of what our clients do. Again, especially when you are talking about airplanes, whether it's a two or three hundred thousand dollar piston [00:05:30] airplane or even a jet, the cost of the equipment obviously is significant. So if you start a business with an airplane it's very difficult, whether you are talking about aerial photography or even training if you are CFI. Generating enough revenue to justify an airplane is not easy.

How we look at the airplane,again, we are trying to utilize your existing business income and revenue to justify the airplane. And some of the other business opportunities include you may be leasing back to a flight school for flight training. [00:06:00] Again, some of that could be done with the right tax situations if you are a business owner. You run your own business, you have a lot more flexibility in terms of how run the business and utilize an airplane.

Income tax benefits, again, once you have a business aircraft that you can justify, pretty much everything out of the pocket is deductible. The deduction clearly is depreciation and I'll go into some of the details of what that involved. But training, [00:06:30] hangar, fuel, insurance, maintenance, pretty much anything you spend on the airplane can be deductible. Deduction for the airplane or any expenses is always based on the business use percentage. And every year we look at the business use percentage, if it's 80% business, boom. You write up 80% of all your cost and expenses. And again, some of the timing of finding an airplane right now in the fourth quarter is very favorable to the taxpayer and I'll go into some of those details in a little bit.

[00:07:00] Depreciation. That's the biggest incentive that you can generate from the airplane. In the tax code, there are multiple ways you can write up an airplane. You can spread it out, use what we call MACRS, M-A-C-R-S, double declining balance method. If you want to slow down in depreciation just use strike line, you're allowed to do that. In addition to some of the incentives available right now, like 50% bonus depreciation or section 179 expense, so there are multiple ways to

[00:07:30] write up an airplane and depreciate the airplane and your situation will dictate what makes sense. And clearly if you have plain out taxable income, if you want to write up the whole thing up to five hundred thousand, that's available.

Section 179 expensing is one of the incentives of that the tax code allows. And it applies equipment in the business not just airplane. The law has changed a couple

[00:08:00] years back, so every single year a taxpayer can expense up to five hundred thousand on any business equipment purchase. The five million in parentheses is the proposed tax reform that may even bump it up to five million dollars. It's kind of ... it's kind of crazy to think about. I mean in theory you can spend five million dollars on a used check and you can expense it immediately. So section 179 is a very nice incentive for business owners that has the income and utilize an airplane.

[00:08:30] It does have a couple different requirements, like the business has to have an income to take advantage of section 179. So you do buy a husky for three hundred thousand and we can maintain a 100% business use this year. Boom. You can literally write off three hundred thousand against your income in your business.

Bonus depreciation is another incentive. This one does apply only to brand new

[00:09:00] airplanes. Section 179 applies to both new or used airplane. Bonus depreciation has only new and it can be used in combination with section 179 and 50% bonus depreciation is what is allowed for 2017 as of right now. It is supposed to go down to 40% in 18 and 30% in 2019. And then, it is phased out to 0 in 2020. Again, some of the tax reform being discussed, 50% may become a 100%, so you can literally

[00:09:30] expense any brand new equipment with no caps. You can buy anything at this point, you'd have the ability to take 100% bonus depreciation, if the tax reform bill does get passed.

This is the next slide is the general various end of depreciation schedule for any business airplane. This is what we call MACRS, it's a double declining balance

[00:10:00] depreciation method. All the percentages change a little bit after September 30th when a purchase is made in the fourth quarter, so again if you don't have a lot of income this year, but you're expecting a good year, this may be the way to use. Because in year one, 2017 you only get 5% of depreciation if you do buy an airplane. But you can look at the second years, 38% and then 22% in year three and

etc. So yeah, a lot of the depreciation methods of how much you take is
[00:10:30] determined really based on your own individual tax situation and how much income you have this year or the following year.

This next schedule is if the purchase happens before September 30th, which we know we're past September 30th right now, but just as a FYI, this is the depreciation schedules that you're looking at typically. 20% the first year and 32% the second year and you can see, for the first two years you write off 52% of an
[00:11:00] airplane. Even if you decide not to take advantage of any of the accelerated section 179 or 50% bonus. So, I mean, the depreciation schedule for a business user airplane is very generous even without the incentives.

And this is a simple example of a three hundred thousand dollar purchase, if you do buy an airplane and you just decide to use a regular depreciation schedule declining now. Again 2017 year one, is not a lot of deduction. It's not a lot of
[00:11:30] savings, but the big number is you know two, 38%. You can write up a 114 thousand and if you're at the 45% marginal tax rate, tax bracket, you're saving over fifty thousand in tax payments to deduct. Or if you have a lot of income and you can utilize section 179, boom, you write off the whole thing immediately and you're saving yourself significant taxes.

[00:12:00] The depreciation can only be taken when the asset is placed in service, so placing an order, signing a deposit or putting up a deposit is not enough, so we have to have the airplane closed, legally owned by you or your CEO, whatever the structure is. So if you have any interest in any airplane, whether it's a husky or anything else, the key is to make sure there's an airplane available out there and you have to start early enough to make sure that pre-buy or all the financing is arranged timely. Just because if you cannot get the airplane purchased by December 30th you cannot
[00:12:30] take advantage of the deductions.

Some other general income tax issues that we deal with with our clients. Again, what we do is we don't prepare your income tax returns, we work with your CPA in terms of the airplane specific issues. Some of these issues, again we talk about this every day and a regular tax guy may not, so that's kind of what we do. Recapture of
[00:13:00] depreciation, if you are a current aircraft owner and you decide to trade up to an X-1. If you sell the current airplane, what we call will recapture depreciation.

And I'll go into a little more detail about what that means or if you're in the real estate business you may be familiar with the like-kind exchange exception 10-31 tax code. It applies to airplane also. Personal use and business use, that's a very hot topic when you're dealing with airplane, because just I mean, pretty much
[00:13:30] everybody always have some personal use what is taking a family on vacation or whatnot, so we have some documentation in flight log that we ask our clients to keep for tax purposes. Because if there's any time there's an audit, that's the issue that the IRS likes to discuss. Is it a toy for you to fly around in, is this actually a business airplane and so forth.

[00:14:00] So the other issues that may come up is passive loss and hobby loss rules, again, because airplane we are usually targeted by the government unfortunately. They like to think of the plane as a toy for the wealthy. They like to throw a lot of these deductions and limitations at you, so the planning if you do have an interest with an airplane, proper planning certainly is very important in documentation, keeping a good record. And that's some of the stuff that we really train our clients and ask them to keep very, very good records accordingly.

[00:14:30] Recapture of depreciation, this is just a basic simple example. You buy an airplane for three hundred thousand. You may be taking section 179, you may be depreciating it over[inaudible 00:14:38]. That's just so you take three hundred thousand of depreciation that will live up the plane. Now your tax basis is reduced to zero. So when you sell the airplane, what do you sell it for? Whenever you sell the airplane, there will be a gain recognized. Let's just say if you sell it in five or six years, the plane is worth a hundred and twenty thousand. A hundred twenty

[00:15:00] thousand becomes what we call, recapture of the depreciation. This is a gain taxed as ordinary income. It is not capital gains. A lot of times some of this information that people believe that you can get a capital gain tax like treatment, but that's not accurate. Recapture of depreciation is taxed as ordinary income.

And like many of our clients, they may start with a piston airplane, but unbearable, they like something faster and bigger and they'll move up. So by doing a like-kind

[00:15:30] exchange or maybe trading in your current airplane to a dealer to buy the next airplane, you can prevent the gains to be recognized on the sale of the first airplane. So if you move up to a half a million dollar airplane, the hundred twenty thousand gained is now deferred. You don't have to write a check and pay tax on it, but then you continue to depreciate the airplane. So again, it's very common in our industry, everybody seems to move up and go to something bigger and faster, so

[00:16:00] that kind of exchange rule certainly helps into avoid recapture. Now, the tax reformat does have a provision to try to eliminate 10-31 that kind of exchange for airplanes or other equipment. So again, we don't know what will get passed, but it is being talked about.

IRS audit risk, again this is a very common topic when I talk to clients or prospects

[00:16:30] or even sales people. In reality, audit is still a very rare occurrence. Everyone of our clients have airplanes, but we certainly don't have many audits going on in our history, really, in the past 15 years, knock on wood. The key to avoid high risk audit is to have an ownership structure that is favorable and not draw attention to return. A lot of times you talk to your attorney and they just set up an LLC join airplane. While we do utilize LLC often in our structure, but setting up a standard

[00:17:00] LLC joint with an airplane and generating losses and depreciation. Unfortunately, that is one of the higher audit risk scenarios.

Our work is really is to try to come up with a structure depending on what your current tax and business structures are. And come up with an airplane ownership

structure that makes sense. Tax efficient, maximize your deductions and comply with what are stake sales and use tax or FAA regulations. That's really the key of
[00:17:30] what we try to accomplish when we talk to a client and prospects.

Jump over to sales and used tax planning. Depending on where you live, some states do not have sales taxes, it may not apply to you depending on where your home is. A very frequently asked question, by a lot of people, can you set up a Delaware house sale or Montana or Oregon to buy an airplane and not pay tax.
[00:18:00] Well, the answer is sort of yes. There is no tax in those states, because they don't impose tax on anything in those tax free states, like Delaware or Montana. But sales and used taxes based on where the airplane lives is not necessarily where you live.

I mean if you're living on the border between two states and you decide to hang a plane in a different state. Sales and used tax laws apply based on where the airplanes is hangar is in, primarily based. And if you do have a second home, then
[00:18:30] you go regularly to visit for winter and whatnot. You actually may have exposure in two different states. So depending on where your flying takes you and how often the airplane is hangar in different areas you may need to be concerned about doing the planing in multiple states.

The hide-and-seek, this is what I call hide-and-seek game and still very, very common out there. People will stop inside a Delaware house, even within a couple months they will get a letter from the state from revenue asking for a tax, because
[00:19:00] it is kind of hard to hide an airplane, unfortunately. And you know, every state is fighting for that extra revenue these days and with aware and flight tracking and various methods, every state on the map goes through FAA registration because its public information. And on top of that, some states will send some people to their local airport, get a list of tell numbers from the airport manager. So there are multiple ways that they can find your airplanes in the sales tax, so we certainly do not propose any kind of hide-and-seek in terms of sales and use tax.

[00:19:30]

Sales tax is assessed at the transaction of the sales, so if you take the [inaudible 00:19:37] in the factory in Wyoming or whatever state, depending on the state involved typically that's not a sales tax applying, because there are many different exemptions that may apply. But when you bring the airplane back to your home state, that's what the planning really needs to be focused on, is your home state,
[00:20:00] how they tax airplane, whether they have exemptions you can meet. And we use the term sales and use tax kind of interchangeably typically, they are usually the same tax rate. If you already paid sales tax, you will not have to pay used tax again. But it's not, again depending on where the states you visit, or if you have two homes and if you have two airports, two hangars. Sometimes, you may get double taxed in some rare situations. So again, planning is important in terms of looking at where the airplane is based and what the local tax law is on airplane.

[00:20:30] Used tax again, it is the same tax rate usually. In the old days, if you order something online and you don't have to pay tax. But technically, when your computer or when your T.V. arrives at your house, you're suppose to voluntarily send in what is called a used tax, because the asset is being used in your home state. And clearly, with the airplane being a high dollar amount involved, states are very interested to apply used tax to the airplane and yeah. Airplanes, it just draws a
[00:21:00] lot of attention unfortunately, so again, planning is critical in terms of buying before you buy an airplane if you decide to claim certain exemptions all the planning has to be done prior to closing.

You hear a lot of talk about, in terms of closing and fly-away exemption. Not every state has a fly-away exemption, in fly-away has ... again, every state can be different so you don't necessarily want to assume hey, does the state have an
[00:21:30] exemption. You want to make sure the specifics of the fly-away exemption applies. For example, Florida is a very common state to take the delivery of the airplane, because there are more airplanes down there, but unless you are actually buying an airplane from a Florida dealer, you actually do not qualify for the fly-away exemption. There are a lot of horror stories. Hyper Aircraft, for example, they have a factory there. Some of their customer delivering the airplane in Florida and they
[00:22:00] get a tax bill, not understanding what the fly-away exemption is. Again, fly-away exemption becomes depending on the state. Every state is a little bit different, most of the time if they ever do fly-away exemption, you can take delivery of the airplane, fly home without incurring any sales tax to the local state.

There are many different kinds of exemptions available, so most of the clients do not actually pay sales tax, when they buy the airplane, because we can help them.
[00:22:30] One of the many exemptions available. In some states, we have what is called a casual/occasional sale exemption for sales tax and used tax. Texas, New Jersey, Arizona, and Nevada all have that. But again, each state does have some different requirements, but what casual sale really is some people like to call it a garage sale exemption. If you stop by the local garage sale in the neighborhood, when you buy something obviously you don't pay sales tax. So in an airplane environment it can
[00:23:00] apply with a direct fact situation, and if you happen to buy an airplane from an individual seller and your home state is applied with a casual state exempt, you can actually be exempt from sales and used tax.

The more common exemption we utilize is the renting and using exemption. Used as an internal leasing arrangement and I'll go into a little more detail. If you happen to have an airplane that is being used for commercial operations charter or even
[00:23:30] airlines, a lot of times those airplanes have exemptions also. Antique aircraft if you buy a really, really old airplane some states do not tax you, but again all these things are depending on your home state. So you need to be familiar what is available and what kind of exemptions are available at your home state.

Casual sale again, only applies when the transaction is between two individual sellers, seller and buyer typically. When a business is involved sometimes state will

[00:24:00] disallow the casual sale exemption and unfortunately, we do buy a brand new airplane from a broker manufacturer directly. There is no casual sale exemption. So a new airplane purchase, typically we look at the next exemption that we utilize, the rental and leasing exemption. It essentially is an internal leasing structure, typically, we do utilize an LLC to buy the airplane and for sales and used tax purposes you'll operate as a leasing company. It's really similar to if you lease a car, [00:24:30] every lease payment you make on a monthly basis you pay some sales tax on the lease payment. This is really essentially the same exemption. The only difference is you owe the leasing company and you're also the renter. So the leasing is really strictly just an internal leasing function, transferring money from the right pocket to your left pocket and most of the states we're allowed to do that. It pays sales tax based on the rental revenue, based on how much you fly on a monthly or quarterly basis.

[00:25:00] Now, again, airplane is being targeted. Even though, the tax code clearly allows rental exemption, but because the nature of the transaction is a single party. You're renting from yourself, so a lot of times we do get some extra scrutiny from the state on revenue and making sure you charge yourself a fair and reasonable market value, rental rate is very important.

Just go very quickly into property tax planning. There's not a lot of planning [00:25:30] available, unfortunately. Depending on the state, for example, Texas does have a very, very high personal property tax, right? Some counties could be three percent of the value on an annual basis and property tax is like sales and use tax, it is strictly based on where you base the airplane. So if you have some flexibility between two states, for example, you may want to plan that accordingly and pick up a state or county that does not have a high property tax rate. Or in the [00:26:00] Carolinas, they have very, very high personal property tax rate, but the next county over may have a very low rate. So that's about the only planning available is just to familiar yourself with what the rates are being charged and if there is some flexibility, logistically it makes sense. You may just want to base the airplane in the lower tax location and airport.

[00:26:30] What we do with our clients, typically, we will come in again as an airplane specialist and we'll review with you and advise your lot, as we do a conference call with your CPA, understand your current structure, and we'll give you a recommendation, specific recommendation on how best to own your airplane if you do have a reasonable basis to write off the airplane and you run a business that need an airplane. That's what we do and we including setting up DLC, drafting the leases, we'll pretty much hold your hand and your CPA's hands for that matter, [00:27:00] typically on a three year basis and tell you exactly how you need to document the airplane. How much can be written off. Personal use, business use, how you plan and document things accordingly to maximize deductions. If there's any audits, whether it's a state sales tax issues, IRS issue, we will represent you as part of our consulting.

[00:27:30] And that's the end of my slides and this is some contact information for our office and email address and all that. Fred McCarter is my business partner. I travel quite a bit, but Fred is usually in the office, so both of us can talk to you guys and give you some ideas of what is available. We can help you, certainly would love to work with you guys.

James, we can open maybe for some questions.

James Kerr: Yes, thanks so much. And you'll see in your control panel that there's a section to ask questions. Go ahead and start asking those questions and I'll help Daniel take a

[00:28:00] look at those. We did record this presentation and we will make a transcript, so we will send that to you along with Daniel's slides. Daniel are you able to see the questions come in from your side?

Daniel Cheung: I don't think so. Let me ... hang on. Yeah, I understand a lot of times you have a

[00:28:30] personal tax situation. You want to call us or email us directly. We'd love to at least talk to you and give you some good information and assess your situation accordingly.

James Kerr: Right, and as a footnote. Daniel you mentioned that delivery must be by midnight on the 31st of December, 2017. Is that correct?

[00:29:00]

Daniel Cheung: December 31st and it is kind of crazy. We do a lot of work after Christmas and a lot of times when you review your year and situation where your CPA tells you have a very good year, you have come to a bunch of taxes. So a lot of times we run into a loss situation, when folks scramble to get an airplane completed and sold and purchased by year end. So yeah, you have to ... I mean, technically, you don't have to actually fly the airplane. But with the kind of deductions we're dealing with my

[00:29:30] advice is certainly at least take one business flight, even on December 31st whatever it is. To at least document that you placed the airplane in service, before December 31st, 2017.

James Kerr: And as far as the accelerated depreciation if one does take delivery before midnight and uses it for two hours and those two hours are for business use, then technically it's 100% business use for that calendar year?

[00:30:00]

Daniel Cheung: Yeah, actually, that is a great, great question. I was going to go into a little more details of that. This time of the year is kind of odd. I mean, the incentives, the section 179, or the bonus depreciations, they are not pro-write up. So literally, if you have one flight, two hours, one hour, it is a 100% business, you have a 100% business use for 2017. And you qualify for the bonus or qualify for the section of 179, you can write up three hundred thousand with the progression. So that's why,

[00:30:30] we are so busy this time year. Again, a lot of folks are doing well with the economy and they happen to have a big tax bill and there's not a lot of equipment that can generate this kind of deductions that quickly.

A lot of these incentives are, again, I don't want you ... I cannot really overemphasize. The planning is important because you just set up LLC, jump on the airplane leased to your business, there are different regulations that apply to

[00:31:00] airplane that may prevent you from taking the bonus depreciation. So it is not really a cookie cutter process, I mean we do spend time with you, understanding your tax situation and come up with a situation that makes sense for you.

And the personal use and business use, I'll go into a little more detail on that. In the past, before they changed a law about five years ago now. You just look at your flight hours, flight log. Let's just say you have a 100 hours flying this year and 80

[00:31:30] hours of business. Well, you have 80% of business use. But after the law change, we actually have to lock every passenger on every single flight. So if you are flying for business, but you decide to bring a buddy or kid or grandkid, whatever riding along. That flight could become 50% deductible, because you have a nonbusiness passenger on the airplane.

You don't do that for a car, you know. You drive a car to a meeting, just because

[00:32:00] your wife or somebody else is riding along, it doesn't change the deduction, but for airplane it does. So if you are currently an airplane owner and you have nothing keeping track of passengers, you'll want to look into that and talk to a CPA about it, because the tax code requires that information and that's why it's almost impossible to maintain a 100% business use, because again, most of you guys have pilots and you love to fly. And you like do things with the airplane, but even though, again, the key is just because you are on a business trip if you have non

[00:32:30] business passengers on your airplane that trip is no longer a 100% business.

So the beauty of buying an airplane this time of the year is you only may have a couple weeks left in the tax year and you certainly can make an effort and that certainly is our recommendation. You want a 100% business use, you don't want any non business passengers for the rest of this year. And then you can maximize every dollar and deductions available.

[00:33:00]

James Kerr: And just as a footnote, we at Aviat do have a handful of planes, new 2017s in inventory ready for delivery by December 31st midnight, so be sure to look at that inventory page on our website: aviataircraft.com. I'm looking through the questions here, Daniel, and many people are saying thank you. You really are a rockstar, so I'm going to launch a [crosstalk 00:33:19] and ...

Daniel Cheung: I appreciate the support and it is a small industry out there. I know a lot of friends

[00:33:30] and clients out there and we truly try to do the best we can and help everybody out.

James Kerr: There are a few questions here that I want to read off to you. One is from Rick. He's asking about schedule F as in foxtrot. So do these talking points here apply if he's the aircraft for a Forestry Operation that's reported on a schedule F?

Daniel Cheung: [00:34:00] Yeah. It can be. Schedule F or schedule C as a sole provider, again, the justification is the key. I mean if you can justify the aircraft being a reasonable use for your business, whatever the use is the depreciation can be taken on schedule to reduce your income whether it's farming or other schedule activities. Yes, it can be done.

James Kerr: All right. And Mark is asking, does the business using plane need to have actual income more than the value of the plane?

[00:34:30]

Daniel Cheung: Well, that goes back to one of my earlier slides. If you have ... let's just say you were buying an airplane for flight training and leased it to a flight school. That's an airplane aviation business you're starting. Now, if you're a startup business, you don't always make money immediately, so you know if you lose money initially for the first year, it's not necessarily bad. But again, because of the depreciation involved, there is the hobby loss rules keep coming into play, when your business [00:35:00] continues to lose money on an annual basis or three out of five years, for example.

Now, the flip side of that is my point about, we want to use an existing business to utilize the airplane, so if you own a construction company that is very profitable and you have job. [inaudible 00:35:14], then no, within three, four, five hours drive of your home office. You are utilizing your existing construction business income to justify the airplane. That is always the most efficient way to justify the airplane, so [00:35:30] the answer is not necessarily you don't need a lot of revenues from the airplane in order to say it's a business airplane, but if you are looking at starting some sort of airplane specific business. Or I talked to folks about [inaudible 00:35:41], it's a legit business use. Now, how much revenue you can generate from that business to say, you can have a profitable business and not just a hobby.

That's again, in an audit situation that's the kind of questions the IRS likes to throw [00:36:00] at us. Yeah, we are generating five thousand a year on revenue and you're trying to write off a three hundred thousand dollar airplane, that would be a situation that I say, yeah, I don't think you can pass a [inaudible 00:36:08] test. But if you bring it, let's just say 50 grand a year for five or six years every year, that's five and three hundred thousand, four hundred thousand in revenue. Then, writing off a three hundred thousand airplane can be reasonable. So that's not really a black and white of what is good and what is not good. And sometimes, you cannot control [00:36:30] your business either. I mean, if there's an economy have a hiccup and everything slows down, well, you lose money. But if your original intention of making money is about, you can still have a legitimate deduction.

So revenue by itself is not really the factor. You have to look at the overall business and decline.

James Kerr: [00:37:00]
So there's a ... yeah, related to that Joe asked, he says he doesn't pay annual tax on his plane and for the write off for depreciation and or operating cost is what he's looking for. And that can he obtained from any use other than business use?

Daniel Cheung:
No, unfortunately, no, a lot of times I get questions about angel flight or charitable use of a plane. If you do use the plane for those reasons, what are allowed is just a direct [inaudible 00:37:23] expenses for the flight. Which is fuel and oil, that's [00:37:30] about it. You are not allowed to take any fixed cost up, do [inaudible 00:37:31] allocation of what all your expenses are if you are doing charitable type flights.

No, I mean, any deductions, depreciations, or expenses for that matter, it has to be based on some sort of business use, again. You have an existing business, that's the easy enter. You can justify and control the use of the plane to grow the business, [00:38:00] but pretty much anything you're writing up seeing a deduction for has to be business related.

James Kerr:
Robot says, he recalls hearing recently that it made sense to establish an LLC for an aircraft, not so much for a liability shielding, but that you can sell the LLC.

Daniel Cheung:
You know, I do get those questions regularly. We are not a law firm and I am not an attorney, so I cannot give you legal advice per se. But I sit in many conference calls [00:38:30] with Aviat attorneys over the many years and LLC certainly is not a liability protection tool, because especially when you are the pilot. As you know, unfortunately, most accidents are caused by pilot errors, so if you messed up and you caused an accident, you are personally liable. That doesn't matter if you have an LLC or corporation only airplane. So the LLC requirement, for IRS tax income purposes, there is no requirement to set up an LLC to an airplane.

[00:39:00] But depending on where you live, we need to control sales and use tax. A lot of times we have to have an LLC as a leasing companies, so we do regularly utilize an LLC for ownership, but for income tax purposes by itself, that's not a requirement for income tax reasons to set up an LLC. Now, whether you can sell an LLC, if I'm advising the buyer, I would never advise somebody to buy somebody else's LLC. [00:39:30] Sometimes, there may be ... in some limited situations there may be some sales and used tax benefits by buying somebody else's LLC. For example, let's say you're from Indiana, you're already paying Indiana 7% when you buy the airplane. If I were to buy your LLC and I live in Indiana, I think that is correct that I would not have to pay sales tax at the end to the state of Indiana, because the airplane tax orderer paid by the LLC.

But if you look in the different state, again it depends on the state, if the buyer's [00:40:00] from Ohio, well, just because you originally paid Indiana sales tax it doesn't mean anything to Ohio. They may still assess use tax on you when you fly back to Ohio. So buying somebody's LLC, it sounds good on paper, but in practice I just don't think that's a good idea. Again, if I'm advising my clients, I'd just never would. In

[00:40:30] addition to the legal reasons of you just don't know there's a hidden [inaudible 00:40:27]. Maintenance will not pay from a couple years back, because if you buy somebody's LLC or operation for that matter, you are inheriting everything behind that company from day one.

James Kerr: And then Jeffrey is asking, does a passive ownership structure compromise the tax advantages?

Daniel Cheung: Yeah, passive loss is a real issue and especially when we're dealing with sales tax planning. We do need to let the airplane to defer the sales tax, for example, but

[00:41:00] with the proper structure and ownership structure, we can get around the passive loss routes ... well, I don't want to say easily, just because we do it every day, but the passive loss routes is a real issue. If you set up a structure that is a leasing in nature or leasing to a flight school, for example, that can fall under the passive loss routes.

Just for general information, passive loss routes typically apply to real estate. The tax code says if you have passive losses from anything including an airplane, it can

[00:41:30] only offset passive income. If you own a building and you collect rents from a tenant, that's passive income, but most everybody that have a day job or work in a business, what you earn is a wage of commissions of business income. They are active income. So if an airplane generates passive income, you cannot use that to offset your business in active income. So that is a trap that is a great question, because we do look at passive loss routes very closely in our structuring. And with

[00:42:00] the right structure, in sometimes utilizing different elections, like a grouping election you can get around passive loss rules, but it is an important issue, because again, all these deductions sounds good on paper, but if they are considered passive then you cannot utilize it against your business income.

James Kerr: And so, Grant commented, it sounds like sales/use tax is difficult to avoid paying if the state the plane is hangared in charges sales tax.

Daniel Cheung: Can you repeat that, James?

[00:42:30]

James Kerr: Yeah, he comments that it sounds like sales/use tax is difficult to avoid paying if the state the airplane is hangared in charges sales tax.

Daniel Cheung: Well. To completely eliminate it, there are only a few states that have exemptions that allow that. For example, it's kind of silly to even say that California actually has the best sales tax exemption for airplane in the whole country. And it is an interesting commerce type exemption. If you have business use outside of

[00:43:00] California and you only need to fly the airplane for the first six months, all the stake half the time. You can get exemption from the airplane completely and it's only a six month [inaudible 00:43:09].

[00:43:30] Now, in some of the states, actually Illinois may be the only state in the country that we have no solution for sales tax. If you buy an airplane part 91 use, you pay the tax. Now, the solution to Illinois is, like a lot of people in that state, that's just getting out of the batch. So if you are close to downtown Chicago, for example, and it is convenient to base the airplane in [inaudible 00:43:33], Indiana across the state line. Boom, Indian sales and use tax laws apply and there are solutions to Indian sales and use tax or Wisconsin for that matter if you live in a suburb of Chicago. 5-North and you can base apply in Kenosha, Wisconsin. Boom, that can get you out of Illinois sales and use tax.

[00:44:00] But like I talked about earlier, the rental-leasing exemption is very common and it's not free. You still pay a little bit of tax, but at least you pay a little at a time over time. Now, if you own an airplane for 12, 15, 30 years, you may end up paying more on the rental and leasing exemption, but as most typically the case, allow the clients after two or three years, get ready to sell and move up to the next one. So you would have only paid three years worth of sales or use tax on the rent. So the rental and leasing exemption certainly is very tempting, we do that for almost every one of our clients unless we're dealing with states that don't have sales tax or [00:44:30] we have another exemption that qualifies.

So it's not free, the rental-exemption certainly applies to most of the states out there.

James Kerr: Joe is asking about being a commercial pilot, would flying the airplane for personal use qualify as an education experience towards commercial session. In other words, making your pilot ...

Daniel Cheung: [00:45:00] Yeah, I mean, if you're talking about depreciating the airplane, an asset that is worth a hundred thousand dollars and that's different. It's still relatively difficult. I mean, you can take some educational type deduction. I mean, if you rent an airplane ... dependent on the dollars involved, but that by itself, that doesn't create a business use for the airplane. Let's put it that way. So we're looking at buying something and take depreciation and the reasoning is for training. No, that would [00:45:30] not work, unfortunately and again, the airline jobs and W2 status that has a lot to do with that too, because again the tax code is not friendly to W2 employees. So it's very limited, unfortunately.

James Kerr: And just two more questions here, Daniel, and then we'll wrap it up. The question is about commuting to and from work. So in this case, he doesn't own the business, but he works for a large medium size company and uses the plane to go back and forth.

[00:46:00]
Daniel Cheung: Yeah, unfortunately, I just don't always have good answers, unfortunately or good news. When you're a W2 employee and use your own plane to fly around, currently, the tax code does allow under itemized deduction what is called

[00:46:30] reimbursed business expense. But commuting in that fact situation, is considered personal expense, just because you live away from the office, that's your choice. That's how the tax code looks at things. Now, if you're a business owner, and again, the tax code is just favorable to business owners and all that. If you have a business owner and you have a second home or your home is far away and you commute in your airplane to the office or to your second home for that matter, there is actually some planning opportunity there to treat those commuting use as a fringe benefit. So you own the business or you're a key employer of the business, we can impute [00:47:00] an income to the employee, recognize that as additional income and the business can actually treat commuting use as deductible business use.

And it does happen quite regularly, as you can imagine. A lot of clients do have second homes, winter homes and whatnot, so with proper planning and utilizing what we call the SIFL, S-I-F-L, is a fringe benefit calculation on the tax code. The corporation, the business, actually can deduct commuting use.

[00:47:30]

James Kerr: Well, Daniel, I want to thank you. Again, there is still so many questions and I think some of them are very specific and probably best answered if they can reach out to you directly. Is email the best way to get in touch with you?

Daniel Cheung: Email and on office, I'm actually traveling out of the country next week on a business trip, but from Fred McCarter, my partner is there and we have an attorney in the office, so those guys can certainly help you guys. But email is always good [00:48:00] and I'd be happy to entertain all these questions.

James Kerr: And it was such an informative session. Should we be doing these a few months, may in August? When's the perfect month for ...?

Daniel Cheung: Well, the thing is, fourth quarter is always the busiest time. Most people may not even be thinking about text planning until towards the end of the year, they don't realize they have a big tax bill coming up until they do the year end planning. But [00:48:30] certainly it doesn't hurt to maybe do something and we can maybe do something more specific topics that have interest. We can surely do something along those lines, yeah.

James Kerr: Great. Well, thanks again, Daniel, and I want to thank everyone for joining. As I mentioned, we did make a recording and we will make a transcript and Daniel it's okay to share your presentation here with the ...?

Daniel Cheung: Absolutely, absolutely.

James Kerr: Alright, well thanks so much and have a nice weekend and happy Veterans Day.

Daniel Cheung: Thank you everybody. Thank you.