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# Aviation Tax Basics

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- ATC was founded in 2003
- Office located in Columbus, Indiana
- Born and raised in Hong Kong
- Senior year of high school at Long Beach, Mississippi
- Graduated from Indiana University
- Married, two sons
- Naturalized Hoosier

## Aviation Tax Basics

- Income Tax Planning
  - Who can write off aircraft expenses?
  - What is deductible
- Sales / Use Tax Planning
  - Can I avoid sales tax by setting up a Delaware corporation?
  - What are some exemptions available to minimize sales / use tax?

# Who Can Write Off an Aircraft?

- Business Owner
- Self Employed Individual
- W2 Employee, retired…
- Key - Business Justification – “smell test”

## Who Can Write Off an Aircraft?

- Ideal fact situations:
  - A consultant owns a consulting company, or
  - A contractor owns a construction company, or
  - A doctor with a medical practice
  - Visit clients, attend trade shows, job sites, prospects
  - A business aircraft is justified to facilitate these business travels
  - Consulting or construction or medical revenues are used to justify a business aircraft
  - It is not always the “least expensive” way to travel

## Who Can Write Off an Aircraft?

- The aircraft is a business tool in a profitable business
- *We do not want to start an aircraft business*
- We have a profitable consulting / construction business utilizing a business aircraft
- It takes significant revenues to justify an aircraft – starting from scratch is extremely difficult, aerial photography, banner towing, leaseback to flight school, etc.

## Income Tax Benefits

- Depreciation
- All operating expenses are deductible
  - Training
  - Hangar
  - Fuel
  - Insurance
  - Maintenance

# What is depreciation?

- Tax depreciation is an income tax deduction that allows a taxpayer to recover the cost or other basis of an aircraft
- It is an annual allowance for the wear and tear, deterioration, or obsolescence of the property.
- MACRS – Modified Accelerated Cost Recovery System (double declining balance)
- Straight Line Method
- Depreciable life is 5 years for Part 91 use
- 50% Bonus Depreciation in 2017
- Section 179 Expensing $500,000

# Section 179 Expensing

- Permanent Law Change: $500,000 Expensing for small businesses ($5M)
- Total Equipment Purchase: less than $2,000,000 ($20M)
- Husky purchase at $300,000 can be expensed in year of acquisition
- Taxpayer needs earned income and taxable income to claim 179 Expensing

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# Bonus Depreciation

- For 2017: 50% bonus depreciation is available for new aircraft purchase
- 50% bonus available in full up to December 31 delivery
- Can be claimed in combination of Section 179 Expensing
- No taxable income requirement

## MACRS Depreciation Schedule: Purchase after September 30th

- Mid-quarter convention
- Purchase after Sept. 30 and over 40% of all assets acquired
- 43% depreciation in first two tax years
- 66% depreciation in first three tax years

| | |
|---|---|
| Year 1 | 5.00% |
| Year 2 | 38.00% |
| Year 3 | 22.80% |
| Year 4 | 13.70% |
| Year 5 | 10.90% |
| Year 6 | 9.60% |

## MACRS Depreciation Schedule: Purchase before September 30th

- Half year convention
- Purchase by Sept. 30
- 52% depreciation in first two tax years
- 71% depreciation in first three tax years

| | |
|---|---|
| Year 1 | 20.00% |
| Year 2 | 32.00% |
| Year 3 | 19.20% |
| Year 4 | 11.52% |
| Year 5 | 11.52% |
| Year 6 | 5.76% |

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# Example: Husky purchase $300,000 after September 30, 2017

| | Part 91 Use | Depreciation Expense | Tax Savings (45% tax rate) |
|---|---|---|---|
| **Year 1** | **5.00%** | **15,000** | **6,750** |
| **Year 2** | **38.00%** | **114,000** | **51,300** |
| Year 3 | 22.80% | 68,400 | 30,780 |
| Year 4 | 13.70% | 41,100 | 18,495 |
| Year 5 | 10.90% | 32,700 | 14,715 |
| Year 6 | 9.60% | 28,800 | 12,960 |

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# Example: Husky purchase $300,000 before December 31, 2017

| | Part 91 Use | Depreciation / Section 179 Expensing | Tax Savings (45% tax rate) |
|---|---|---|---|
| **2017** | **100.00%** | **300,000** | **135,000** |

# General Income Tax Issues

- Recapture of depreciation
  - Depreciation is a “timing” benefit
  - Recapture is taxed as ordinary income
- Like-kind Exchange – Section 1031
  - Avoid recapture of depreciation on sale of current plane
- Personal Use
  - Proration based on seat hour / mile calculation
  - Personal entertainment / vacation flights are not deductible
  - Personal non-entertainment flights can be deductible
- Passive loss, hobby loss rules

## Recapture of Depreciation

- Purchase Price $300,000
- Depreciation Taken: $300,000
- Net Tax Basis: $ -0-
- Sale Price $120,000
- Gains Recognized: $120,000
- Taxed as Ordinary Income

# Recapture of Depreciation

- Purchase Price $300,000
- Depreciation Taken: $300,000
- Net Tax Basis: $ -0-
- Sale Price $120,000
- Gains Recognized: $120,000

- LIKE KIND EXCHANGE
- Purchase $500,000 replacement aircraft
- Depreciable Basis $380,000
- Deferred Gains: $120,000

## IRS Audit Risk

- Overall, a very rare occurrence
- Key is to avoid scenarios and ownership structures that carry high audit risk
- The art of aviation tax planning – devising an ownership structure that will meet the regulations of IRS, state sales and use tax and FAA, while mitigating potential audit risk.

## Sales and Use Tax Planning

- FAQ: Can I set up a Delaware / Oregon / Montana LLC to buy a plane and not pay sales tax?
- Answer: Yes, sales tax is not due to Delaware / Oregon / Montana, but you can bring the plane home to your home state and pay use tax.
- “Hide and seek” game is not sales tax planning

## Sales and Use Tax Planning

- Step up enforcement across the country
- FAA registration information is forwarded to state department of revenue
- Airport hangar audit
- Flightaware

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## What is Sales Tax?

- Sales tax is a transaction tax assessed at the time of an aircraft sale / purchase transaction.
- If you buy a plane and take delivery in Idaho, technically, sales tax can apply – unless you meet an exemption (fly away exemption)
- Avoiding sales tax on an aircraft purchase is not difficult
- What about Use Tax?

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# What is Use Tax?

- Use tax is assessed by state taxing authority on purchases made outside the state, and "use" in the home state of a purchaser
- Technically, if you order a computer online and the seller didn't charge sales tax, then you are expected to voluntarily remit "use tax" when you return home
- Same rules apply to aircraft purchased or delivered out of state
- Use tax applies when you return home
- States are more interested to assess use tax on an aircraft than a computer

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# Fly-Away Exemption

- Some states allow non-resident to buy an aircraft without incurring sales tax if the plane flies away back home after closing
- Fly-away exemption requirements are different from state to state
- Plane is required to leave within 10 days, sometimes immediately; sometimes immediately after maintenance work
- Exemption applies only when the seller is a registered dealer (Florida)

## Sales / Use Tax Exemptions

- Casual / occasional sale exemption (TX, NJ, AZ, NV)
- Rental and leasing exemption
- Commercial operations (135, 121)
- Antique aircraft

## Sales / Use Tax Exemptions

- Casual / occasional sale exemption
  - Individual selling to individual
  - Texas, Arizona, Kentucky, Nevada, etc.
  - Does not apply to new aircraft purchase from dealer

## Sales / Use Tax Exemptions

- Rental and leasing exemption
  - Deferral of tax
  - A leasing company will purchase aircraft tax free
  - Aircraft is rented to an operating business
  - Sales tax is due monthly on the rental revenue
  - It can be rented on a monthly or hourly basis
  - Related party transaction, extra scrutiny

## Property Tax Planning

- Similar to sales / use tax on what is taxable
- Property tax applies based on where the aircraft is hangared
- Proration of property tax if the aircraft is located out of state part of the year is allowed in some states
- Proration based on out of state landings is allowed in Texas
- Personal use aircraft is not taxable in Texas

What does ATC provide?

- An initial interview to discuss some general background information, how the aircraft will be used, etc.
- Review income tax returns
- Formulate the initial plan
- Discuss the plan with client and advisors (CPA, Attorney, spouse, etc.)
- Implement the plan: entity setup, documentation creation, sales tax compliance, etc.
- Continual, ongoing monitoring during the three-year engagement period.
- Audit Defense

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