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How It Affects You and Your Aircraft

by Daniel Cheung

Editor's Note: With the recent Tax Reform bill signed into law in the United States, and some of it strongly affecting prospective and current aircraft owners, a deeper explanation on what this means to the many U.S. King Air operators was imperative.

The Tax Cut & Jobs Act (TCJA) signed by President Donald Trump in late December was the first tax reform legislation in over 30 years. The TCJA has already influenced the economy, corporate spending policy, and has also made a major impact on the general aviation industry. Business corporations that can utilize a business aircraft for transportation, as well as small companies who have rented aircraft for their transportation needs, should examine how the income

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Depending on your income tax situation, the new tax plan allows you to depreciate your aircraft 100 percent in one year or a lower percentage on a more traditional schedule.

tax benefits can help a company justify the addition of an aircraft as an essential business tool. In this article we will discuss the various tax provisions that will affect the decision to purchase and operate a business aircraft.

1. **100 percent bonus depreciation – this provision applies to all new *and used* business aircraft. Immediate expensing is available in the year of acquisition.**
2. **Section 179 Expensing increases to $1 million, with phase-out beginning at $2.5 million.**
3. **Entertainment use of a business aircraft is no longer tax deductible.**
4. **Elimination of Section 1031 Like-kind Exchange for business aircraft; recapture of tax depreciation is immediately taxable as ordinary income.**

Bonus Depreciation

A tax incentive first introduced in 2001, Bonus Depreciation has always been a valuable tax incentive for businesses aircraft acquisitions. Instead of depreciating an asset over five or seven tax years, a taxpayer can elect to depreciate 100 percent of the acquisition costs or improvements to a business aircraft. This incentive, from its inception, has always only applied to new aircraft, to stimulate demand and create manufacturing jobs. With the implementation of TCJA, Bonus Depreciation has been extended to *new and pre-owned* aircraft; and 100 percent bonus depreciation is in effect until tax year 2022. It will then begin a phase-out of 20 percent annually.

The bonus depreciation also applies to improvements made to an existing aircraft. Avionics upgrades, interior refurbishing, paint, etc., can all be deducted immediately.

With the amount of depreciation available from a business aircraft, it is paramount that taxpayers and their tax advisors consider the various compliance requirements in order to benefit from the sizable tax benefits.

This is a significant boost to the pre-owned aircraft market, as buying a new or used aircraft is now on a level tax playing field with the same tax incentive available. Understand that 100 percent bonus depreciation is available at 100 percent, or zero percent. Therefore, depending on your income tax situation, you may elect to depreciate the aircraft on a traditional five- or seven-year schedule. Bonus depreciation applies also to improvements made to an existing business aircraft. Avionics upgrades, interior refurbishing, paint, etc., can all be deducted immediately.

Below is an example of a purchase of a $3 million business aircraft in 2018, assuming 100 percent business use and combined federal and state individual income tax rates of 40 percent.

Tax Year	2018
Bonus Depreciation	100%
Tax Depreciation	$3,000,000
Income Tax Savings from Depreciation	$1,200,000

Section 179 Expensing

The Section 179 Expensing limit has steadily risen, and with TCJA it has increased to $1 million for 2018.

Section 179 is another option to depreciate a business aircraft or improvements. U.S. taxpayers have the option to elect a specific amount that fits their current year tax situation. Section 179 is a good option for companies that may not need 100 percent bonus depreciation.

For example, a taxpayer purchases a business aircraft for $2 million in 2018. Based on current year taxable income, the taxpayer can elect to expense $800,000 in 2018 and depreciate the remaining $1.2 million over the use life of the aircraft.

Depreciation Deductions	2018
Section 179 Expensing	$800,000
MACRS Depreciation Expense (20%)	$240,000
Total Depreciation Deduction	$1,040,000
Income Tax Savings from Depreciation	$416,000

Entertainment Use of Business Aircraft

Historically, the general rule of IRC § 274 disallowed all entertainment expenses unless directly related or associated with the active conduct of the business. Therefore, the entertainment of clients, prospects, company retreats and other entertainment events where business was conducted immediately before, during or after the entertainment, has been a deductible use of a business aircraft. Flying clients to a sporting event has been considered a deductible business use of an aircraft.

Effective January 1, 2018, TCJA disallows all entertainment expenditures, regardless of whether they are directly related to a business goal or connected to the taxpayer's business activities, which includes entertainment use of a business aircraft. The taxpayer can continue to utilize the aircraft for business entertainment, but these expenditures are no longer tax deductible.

The Elimination of 1031 Like-Kind Exchange

Recapture of depreciation occurs when a depreciated aircraft is sold. The sale price exceeding the remaining tax basis is taxed as ordinary income. For example, a fully depreciated aircraft sold for $500,000 will result in $500,000 taxable gains. Section 1031 Like-kind Exchange is a provision that allowed for the deferral of the recapture gains historically. TCJA has eliminated the applicability of this provision to equipment and business aircraft. Beginning in 2018, a sale of a depreciated business aircraft will result in gain recognition immediately, taxed at the ordinary income tax rate.

The loss of this deferral provision should not create any hardship for taxpayers, as long as a replacement aircraft is purchased in the same tax year. With 100 percent bonus depreciation available for new and used aircraft, investment in a replacement aircraft will create new depreciation deductions that should offset the gains recognized on the sale of the current aircraft.

In summary, with the amount of depreciation available from a business aircraft, it is paramount that taxpayers and their tax advisors consider the various compliance requirements in order to benefit from the sizable tax benefits. Numerous Internal Revenue Code provisions can impact and limit the utilization of bonus depreciation – basis limitation for pass-through entity, passive activity rules, listed property, entertainment use, hobby loss, etc. It is important that an ownership structure should also comply with state sales and use tax laws and FAA Regulations.

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A sound and tax efficient ownership structure should maximize income tax benefits available for a business aircraft, and also mitigate the chance of inquiry from the various government regulatory agencies. KA

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