

BONUS DEPRECIATION EXTENDED – INCREASED TO 100% THROUGH 2011

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Economic Stimulus Incentives in 2010 Tax Relief Act Retroactive to September 9, 2010

New aircraft purchases and new equipment purchases for used aircraft can now be expensed in the year of purchase through December 31, 2011. For 2012, 100% bonus depreciation returns to 50% bonus until it expires on January 1, 2013. In addition, new aircraft purchases (but not new equipment on used aircraft) will receive a one year extension on the placed in service requirement under certain circumstances. The additional first year depreciation deduction is allowable both for regular income tax purposes and alternative minimum tax purposes. Qualifying property must be new, used primarily for business purposes, and meet other tests necessary to qualify for modified accelerated cost recovery system depreciation (MACRS). The new bonus depreciation excludes property acquired under written binding contract in effect prior to January 1, 2008.

Increased Expensing For Used Property Expanded in 2011

Although the bonus depreciation outlined above applies only to new property, the current law allows small businesses to expense up to \$500,000 for 2010 and 2011. This Section 179 expensing is restricted to taxpayers who invest less than \$2,500,000 in capital purchases during the year and is further limited to taxable income. The new law provides for 2012 expensing of \$125,000 phased out at taxpayers who invest over \$625,000.00. The property qualifying for expensing under Section 179, like bonus depreciation property, must also qualify for MACRS depreciation.

Why 100% Bonus Depreciation is Preferred Over 100% Section 179 Expensing

There are three significant benefits of 100% bonus depreciation over expensing: first, bonus depreciation is not limited in amount; second, bonus depreciation can create a net operating loss to be carried back to prior years and result in an immediate tax refund; and third, aircraft have special placed in service allowances available for bonus depreciation but not for expensing. Nonetheless, there will be circumstances where Section 179 expensing may be preferred over bonus depreciation. A taxpayer may take any portion of the expensing election as an immediate deduction, whereas bonus depreciation must be taken entirely, or elected out of by class life of property. This will generally be beneficial

to taxpayers who need less than \$500,000 in write off during the current year. Of course only expensing is allowed for used property; many taxpayers will take Section 179 expensing for their used property and 100% bonus for their new property.

Ordering Rules Remain Unchanged

The method of computing depreciation when these various incentive provisions work together remains unchanged. The expensing election under Section 179 is considered first, followed by bonus depreciation, and then by regular depreciation. This concept is best illustrated by an example in which a taxpayer buys two aircraft, one new and one used, for a price of \$1,000,000 each. The taxpayer will chose to expense the new aircraft under the 100% bonus depreciation rule, but will be limited to the Section 179 expense deduction for the used aircraft. Because the Section 179 expensing deduction is limited to \$500,000, the remaining \$500,000 will generally be depreciated over five years, resulting in a \$100,000 depreciation deduction in the year of purchase.

Prepare for the Coming of the IRS

Although Congress and the President are encouraging taxpayers to invest in new property purchases under these incentive provisions; they must exercise extreme care to sustain the deductions under IRS scrutiny. The Service has a number of tools at its disposal to claw back tax savings so graciously provided by the new tax law. Some of the more common attacks include the following:

1. Business is a hobby, not a business at all – the substantial tax savings available under these incentive provisions can actually provide fodder to the arsenal of the Service in asserting the transaction was tax motivated rather than business driven.
2. It's a passive activity and therefore deductions are limited to this undertaking – common industry practice is to hold an aircraft in a special purpose entity for business and liability reasons. Income tax laws provide for grouping elections that must be meticulously complied with to avoid having the airplane activity be treated on a stand alone basis.
3. Personal entertainment use of the aircraft by owners may reduce allowable depreciation – in 2004 Congress passed legislation limiting deductions to aircraft used for personal entertainment of owners and key employees. Great care must be exercised in both the use of the aircraft and its documentation to guard against loss of depreciation deductions due to these limitations. Proposed regulations also provide for a special depreciation election deduction solely for purposes of computing this limitation.

4. Basis and at-risk limitations – aircraft are often purchased through borrowed funds the debt of repayment of which is amortized over many years. Although funds may be borrowed and repaid in future years without impacting deductibility, limitations exist related to both entity basis and “at-risk” requirements.

5. Is the aircraft new, and when was it purchased – there are definitive rules outlining what is new (and special rules for fractional ownership). There are also special rules relating to contracts for purchase.

6. Other MACRS limitations – there are also restrictions for qualified property impacting related party leasing, business use by shareholders, and domestic use requirements.

As is apparent from the issues outlined above, the assurance of bonus depreciation and enhanced expensing deduction analysis cannot end at the time of acquisition. Although the acquisition of a new aircraft may be an effective business tool, the tax benefits must be carefully planned, documented, and defended. Federal Aviation Regulations also impact issues relating to ownership, registration, operation, and compensation. These regulations must be integrated into aircraft tax and liability issues.

This information is general in nature and purchasers are encouraged to seek experienced legal counsel in aircraft acquisition planning and implementation.