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U.S. GENERAL AVIATION IN CRISIS

NO PLANE = NO JOBS

SAVE YOUR FLIGHT DEPARTMENT = SAVE YOUR JOBS

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Currently, the entire U.S. General Aviation Industry is foundering. As a result of an onslaught of aircraft order cancellations, many aircraft manufacturers have been forced to terminate many of their employees. Not having formal order preservation teams or programs in place have only exacerbated the problem. Granted, a client who has to file bankruptcy will not be able to continue with the purchase of an aircraft. However, it is now becoming apparent that many order cancellations occurred because of a “knee jerk” reaction to an ill-informed public perception problem rather than a well-reasoned, analytical review of all of the facts and circumstances affecting the aircraft buyer. Unfortunately, in a few cases, the entire business failed. But merely placing an order for an airplane did not cause the business to fail.

Discussing all of the various factors that can cause a business to fail are far too numerous to list and are beyond the scope of this article. In future publications, I will discuss how factors such as taxes, interest, inflation, lack of capital, lack of knowledge and increasing accounts receivable impact a business entity’s ability to prosper or even survive in this challenging environment.

OBSERVATIONS: One thing is certain -- flight departments do not destroy companies. However, defective business models, combined with the inability to recognize and react to local and international economic, technological and political developments, will sink your ship. The flight departments, along with the rest of the company will simply be the victim of short sighted management styles, methods and procedures.

In this economy, the overwhelming percentage of business airplanes that are owned, operated or being purchased today, are paying their way in terms of maintaining or increasing profits and thereby maintaining or adding jobs! Any past extravagances, purely for an executive's vacation using the company aircraft to go to some far-off private island accounted for an extremely minute percentage, .000001% of the total hours ever flown by the general aviation fleet, even in the best of times. Unfortunately, for our industry, those very rare occurrences were blown out of proportion by journalistic sensationalism and unfairly tarnished the perception of our industry in the eyes of many politicians, commentators, and the general public for decades to come. The days of any form of extravagance, aircraft related or otherwise, are over!

OBJECTIVES: This article has three objectives. The first objective is to begin laying a foundation for an industry-wide program to enable flight departments to more effectively plead their case to corporate management in order to prevent any more "knee jerk" flight department closures. The second objective is to link business aircraft ownership to both job preservation and creation. The last objective is to enhance communications and general appreciation of business aircraft usage throughout the company and the local community at large. Byproducts of the "Save Your Flight Department" program could range from a much stronger defensive position against the increasing scrutiny of federal, state and local tax regulators and perhaps a re-evaluation of the overall business model so that the business enterprise could survive and prosper in the difficult years ahead.

Accordingly, I will address the following topics:

1. How to position the flight department as a profit center rather than a cost center.
2. Employee morale and local public perceptions of small and large businesses that use private aircraft to maintain, enhance and promote their business activities thereby increasing employment.
3. How the aircraft manufacturers ("OEMS") can help their own case.
4. The tax and financial aspects of the sale of an airplane or closure of a flight department.

Flight Departments as a Profit Center:

Since business enterprises first began to set up flight departments over 60 years ago, they have largely been treated as cost centers on the accounting records of the particular business entity. This is because the efforts of the pilots, mechanics and other members of the flight department, were reduced to a list of aircraft expenses buried on the corporate profit and loss statements.

While the generally accepted accounting principle known as the “matching concept” has been applied by internal accountants and independent auditors to the company’s financial statements, it has rarely been specifically applied to a flight department.

Basically, the matching concept requires that the recording and recognition of expenses for a particular period of time be associated with revenues generated by the enterprise. This is true for all industries, whether the financial accounting period is for a month, quarter or year.

It is the accurate and careful application of the matching concept, in addition to other accounting principles, that produce reliable profit and loss statements for an accounting period. Therefore, in order to provide a fair and accurate financial evaluation for any flight department, businesses must assign at least a portion of the accounting period income to the flight department.

By ignoring the revenue-generating efforts of flight departments, many flight departments will continue to attract the unfavorable attention of controllers, CFOs, etc. Premature, uninformed decisions to sell an airplane or to close the flight department will have many unintended harmful effects for years to come on the profitability of the business, as well as countless other businesses that served or were patronized by the flight department.

Questions: Does your flight department even generate its own profit and loss statements? Why can’t corporations, large and small, public and non public, start assigning a percentage of the entity’s gross income to the internal profit and loss report of the flight department? This could be done on an “internal-for-discussion-purposes-only” report to management on a monthly basis without having any effect on audited financial statements, SEC filings, tax returns, potential FAA problems etc., because there would not be any payment or accrual of funds. Why not implement a documentation procedure whereby some of the company’s income that was facilitated, in part or in whole, by the efforts of the flight department, be allocated to the flight department. I have listed below a number of documentation procedures that will assist companies in implementing a policy that can assist nearly any business in developing a

fairer, accurate and complete assessment of the flight department's contribution to the gross income of the enterprise.

Documentation Procedures:

In addition to not being given any financial credit for their efforts, many flight departments are at a disadvantage in pleading their case because of faulty communications with those individuals or departments who need the services of the flight department. Many times the pilots do not even know the reason for the trip. All they know is that management wants to go from point "A" to point "B" at a certain date and time. For businesses that actually have a formal trip request procedure, this is usually the only information that is found on many trip requests. This minimalist approach has to change for internal management functions and will prove to be wholly inadequate for IRS examination purposes. An aircraft trip request should contain at least the following information.

1. Name of the most senior company employee requesting the trip;
2. Names of all other employees and guests;
3. Dates, times of departure, locations and who will be aboard for each trip segment;
4. Purpose of trip and what is expected to be accomplished by the trip; and
5. Names of persons or entities to be visited.

The trip request should be submitted to the flight department first so that the pilot can match the mission profile to the available equipment. Once the flight department signs-off and indicates that the aircraft and personnel will be available for the trip, the trip request needs to be approved by two corporate officers who are not going on the trip. This is to minimize and prevent allegations that the trip is for purely recreation, entertainment or amusement purposes. Obviously, comments about product samples or items to be brought on the flight that could not be carried aboard a commercial airliner, should always be prominently indicated on the trip request.

Post Trip Report:

Once the trip is over, a post-trip report needs to be completed that indicates:

1. What was accomplished by the trip;
2. Names of persons and entities, along with copies of business cards, that were visited or contacted;
3. Action items for follow up with current or potential new clients; and
4. If you signed a new contract, what could be the potential financial benefit to the company over what period of time?

Copies of the post-trip reports need to be kept in the flight department, as well as circulated to all other appropriate departments to ensure follow up for action items.

Documentation for the IRS Audit:

Several years ago I represented a taxpayer before the IRS Appeals Division. The audit was over and the examining agent had disallowed all aircraft depreciation, operating and non operating expenses for the three year audit period on a 5-6 million dollar BeechJet.

After a presentation of the client's facts and circumstances to the appeals officer it was apparent that I needed something else to provide a turning point in order to persuade the appeals officer to agree with my position. I made the following offer -- I indicated that I would be willing to concede all of the disputed deductions if the IRS would give my client a tax exemption on the \$30 million of taxable income that the aircraft helped to generate during the audit period. I then reached into my brief case and displayed several contract signature pages. The aircraft was still being used to service those contracts. The employees serving those contracts still have jobs today! In two cases, the contracts were awarded over the competition because management was able to negotiate favorable terms, while the competition was still over 1,000 miles away waiting for a connecting commercial flight.

While the appeals officer explained that he could not accept my offer without having Congress revise the Internal Revenue Code, he stated that I had made my point and the tax returns would be accepted as filed. Thus, the decision of the examining IRS agent was completely overruled in favor of the client. All aircraft deductions were accepted. This would not have been possible without complete documentation procedures that linked specific trips to specific contracts.

Employee Morale and Public Perception:

In difficult economic times, many employees may not have a favorable opinion of company aircraft ownership when they see their associates being laid off. The remaining employees may be wondering if their own jobs are safe. The obvious question will be, "Why can't they just sell that airplane and perhaps save a few more jobs?" A company that is in this position has to go on the offensive, and embark upon an employee/ management communications campaign. You are going to have to be just as deliberate in justifying the aircraft to your employees as a good tax advisor is when defending the aircraft deductions before the IRS.

For companies whose employees are aware that the corporation owns an airplane, management should develop an employee communications program that

emphasizes the fact that the airplane has had, and continues to have, a direct and beneficial financial impact on the company in the following ways:

1. The aircraft has played a direct impact on securing new business that enables the company to continue to make payroll. (Companies may want to consider using the “No Plane No Gain” logo on their checks. Consider placing the logo near the signature area above the account number. Every time an employee cashes his or her paycheck and every time a vendor cashes a company check, they will be reminded of the favorable aspects of airplane ownership. Also, consider going to the No Plane No Gain website at www.noplanenogain.org to access the No Plane NO Gain program literature. Still other companies, where appropriate, may want to also consider adopting the phrase --“**NO PLANE = NO JOBS**”. Consider using these phrases on every email you send.
2. The aircraft enables company management to maintain control over distant operations. (In this economy, if you cannot control a branch location, you may have to close it down).
3. Efficiency is greatly enhanced by the ability to visit more locations and conduct more business in the same time than would be possible by using commercial airlines. Emergencies at branch locations can be addressed much more quickly than through the use of commercial airlines.
4. Consider letting some mid-level department managers use the aircraft when necessary. Having two or more mid-level department managers use the airplane for a business trip can save many times more dollars than the combined operating and non operating costs of the aircraft, especially if the trip involves several stops. Just imagine the financial waste of having several employees waiting in security lines, getting to the airport three hours early, suffering because of cancelled flights, lost baggage, lost corporate documents, etc. When the trip is over, make sure the various department managers communicate to their subordinates how effective the use of the company airplane was in saving corporate resources and conducting business.
5. Communicate to the employees that no personal use of the aircraft is permitted and that a very stringent approval process of any trip is in place before the aircraft is used for any purpose.
6. Any personal trips are paid for by using personal funds for other charter aircraft.

For companies whose employees are not aware that the company owns an airplane, management may want to consider informing them of that fact. If they find out “through-the-grapevine,” the employees may not have a favorable opinion of

management. This may breed an element of distrust that you will not be able to dislodge for several years in this economy.

When new business contracts are signed, communicate the fact to the employees and provide a news release to local media stressing the fact that without the aircraft you would not have been able to gain new business or service it. Furthermore, don't forget to let local media know if you use your aircraft to benefit the community in the event of a natural disaster or for charitable purposes. There is no harm in aggressively "tooting-your-own-horn" these days. After all, those who disapprove of corporate/business use of private aircraft are not the least bit hesitant to make their voices heard or take positions that are based upon ignorance or deceit. A carefully designed media release, based upon verifiable facts, can go a long way towards meeting any local resentment that may come from those who are critical of individuals or companies that own and use aircraft for productive societal and job preserving purposes. You may even want to consider informing your local politicians that because of the use of the airplane to get and service the new business, you have been able to avoid laying off employees and have even started a recruiting process to hire more. Any politician who has an ounce of common sense knows that JOBS are the new gold standard and will be for decades to come.

Businesses that use private aircraft need to become a lot more vocal when it comes to defending the "green" side of business aircraft. For example, when an airplane is used on a bona fide business trip, the pilots and passengers are representing the entire company and all of its employees, vendors, customers, etc. that will benefit in any way from the result of maintaining or adding new business for the enterprise. Dividing the "carbon emissions" emitted by any aircraft by the number of company employees, vendors, their employees, aircraft mechanics, FBOs that service the aircraft, hotels and restaurants and any other people that a particular mission impacts would produce an amount of emissions in much smaller amounts when calculated on a net effective per capita basis. When the aircraft is used to go to more than one business meeting location in any particular day, the efficiency increases dramatically. Whether we are talking about the President of the United States, who is representing over 300 million Americans, other heads of state, corporate employees or sole proprietor using an airplane for a business trip the net effective carbon footprint is minute. After evaluating all of the facts and circumstances, use of the private business aircraft for bona fide business purposes, may prove to be the most "green" form of transportation currently available. If industry detractors want to have a credible discussion about "global issues" involving the use of business aircraft, they need to make sure they employ global, all inclusive formulas, objective functions, and constraints within those objective functions in their mathematical logic in order to

perform a credible evaluation of all the facts and circumstances. If they don't, their arguments will be invalid, void of logic and worthless.

How Aircraft Manufacturers, OEMS, Can Help Their Own Cause:

Almost overnight, our economy changed from a "Wants or Dreams" based- economy to a "Needs" based-economy. The rapidity, depth and breadth of this transformation, as well as the sheer magnitude of destruction of capital, caught nearly everyone off guard. In order to prosper or even survive in a needs-based economy, businesses will have to dramatically change the way they bring their products and services to market. Businesses will also have to increase their after- sale services to their clients and generate new business while retaining current clients. For example, the domestic car market has contracted from a 17 million unit per year market to a 10 million unit per year market and will need fewer assembly lines, dealerships, raw materials, etc. in order to remain profitable. The same goes for all manufacturing and service businesses.

Accordingly, aircraft manufacturers will have to make some major changes to the way they market, advertise, manufacture and sell their products. Changes in aircraft design, performance, interiors, etc. will be required if the manufacturers are to be successful in selling their products in this new economic environment that may be with us for decades. The aircraft marketing and sales professionals will have to develop new skill sets enabling them to become aviation business consultants, who also happen to sell aircraft. These skill sets will include expanding knowledge into areas such as taxes, how to analyze and interpret financial statements and business plans and other business documents. Acquiring an understanding of basic concepts in these areas will enable the sales and marketing professionals to interact with sophisticated individuals and corporate management, tax and legal advisors, like never before and will promote a new level of respect for the aircraft marketing and sales professionals. In addition, these new capabilities will result in being able to more accurately and efficiently qualify prospective clients, close more sales, receiving fewer order cancellations, etc. Furthermore, this sort of relationship should also produce a more committed long-term product loyalty. The more knowledge an aircraft business/sales consultant has, the less likely that person will be regarded as just another airplane salesman.

My recommendation to the manufacturers is to develop an in-house curriculum designed to give their sales force the basic tools that they will need to be successful in an economy that is increasing its demands on everyone who wants to be successful. The cost of this program does not have to be a major expense although the personal commitment of the participants will be great. Each aircraft manufacturer already has a tax manager, CFO, general counsel, etc. Why not have these individuals create a course module in their own fields of expertise? Those manufacturers that

really want to go the extra mile could consider working with a local university to custom tailor a course. The only word of caution here is to make sure that the faculty you work with has at least some knowledge of the general aviation industry in order to prevent spending an inordinate amount of time and money training the faculty and ending up with a program that is based too heavily upon theory rather than immediate practical business application.

Once a program “graduate” completes the course, a continual program of personal study and self-improvement needs to be implemented. All true professions, i.e., attorneys, doctors, enrolled agents, CPAs, have mandatory, annual continuing professional education (CPE), requirements. While there is no specific designation such as an aircraft business/sales consultant, certainly having a self study program in place would be beneficial to all. This could be an economical, in-house, program tailored to a specific product line without the need to incur private university levels of expense. When a potential cancellation call does come in, the aircraft business consultant could call upon the in-house tax manager, general counsel, CFO, and others who would be assigned to the order preservation task force.

Order Preservation Not Cancellation:

A byproduct of the aviation business consultant program could result in fewer order cancellations. I believe that a business owner would be more likely to discuss potential business problems with a recognized knowledgeable, professional than a run-of- the-mill order taker of years past.. Some business owners may even seek advice from such an individual if they felt there was a chance of receiving constructive input prior to letting a situation deteriorate to the point where the order cancellation call was necessary.

Clients Not Customers:

Another way that OEMS can help themselves is to foster a more professional corporate culture in which they refer to aircraft owners and buyers. Referring to a prospective aircraft buyer as a prospective **client** as opposed to a prospective **customer** may seem like a small item. However, that change in terminology may well filter throughout the entire organization and bring about many other positive changes that will result in client retention and increased product loyalty. After all, anyone can be a customer of a convenience store....You walk in the door, buy a soft drink, leave and never come back to that business again. You were a customer and may have been treated accordingly. It's amazing how many OEMs treat their clients as customers as soon as the aircraft was delivered and especially as soon as the warranty period is over.

Adverse Tax and Financial Consequences of Selling the Aircraft:

For the last two years used aircraft have been selling at very steep discounts. Many owners have been upside down in their aircraft like many homeowners. This is particularly true of aircraft that were financed with 10% down or less, with a twenty year amortization period or interest only loans. Sales proceeds in this market often do not generate enough cash to pay off the loan. A great number of owners do not have their tax advisers perform a simple tax projection on the sale of the aircraft.

Example: An aircraft was purchased slightly over three years ago for \$10,000,000.00 and was depreciated using bonus depreciation with 100% business use, 5 years MACRS. The loan was an interest only loan with a 10% down payment. In spite of the fact that the company has had a history of profitably using private aircraft in its nationwide business for decades, the company president now wants to sell the airplane because he has heard and read a number of uninformed and prejudicial negative reports concerning the use of private aircraft for business. With very little discussion and no analysis, the aircraft was sold for \$5,000,000.00.

Now let's see what this president just did to his company. Over the three and ½ years of ownership, \$8,848,000 in depreciation was claimed on the company tax returns. This left a tax basis of \$1,152,000. The sale price of \$5,000,000 has resulted in a taxable gain of \$3,848,000. With a combined federal and state tax rate of 45%, \$1,713,600 will have to be paid to the state department of revenue and the IRS. Also the bank is still owed \$9,000,000. Total cash obligations are \$10,713,600. After paying the tax authorities and applying the \$3,286,400 remaining sales proceeds to the loan, the company still owes the bank \$5,713,600! Where will those funds come from? Another loan if the company can get credit? Sales will certainly suffer. Will employees other than the pilot, mechanic and flight department personnel have to be terminated? What about the risk of wrongful employment termination suits? If the airplane has been under a management program and kept in a hangar, there may be lease and management termination penalties. The company's image in the eyes of its customers may be diminished. Now the company will no longer be able to service its clients in distant locations as effectively as before and its market presence in all markets previously serviced by the airplane will be diminished. How do we value all of these unintended consequences that may not be realized until 2 or three years hence?

Summary and Opinions:

I have discussed some of the effects caused by changing from a “wants” based economy to a “needs” based economy nearly overnight. That change has precipitated a vast number of aircraft purchase cancellations, a tremendous loss of jobs at the manufacturer level as well as with aircraft owners. In order to prevent more damage to our industry, we need to reevaluate business models and not make rash decisions to dispose of aircraft or any other major business assets. Accordingly, every business needs to evaluate whether an item or a department is a cost center or a profit center. That may call for new standards of measurement, evaluation and documentation procedures.

Dealing with employee morale and public perception of business aircraft use will require enhanced education and communication efforts. Perhaps a conversion to the ATIS Group LLC coined/adopted phrase of “**No Plane = No Jobs**” is in order. While the “No Plane No Gain” program has been refurbished and is readily accepted within our own industry, the actual intent of the No Gain part of the phrase can be rather nebulous to those outside of the industry. “**No Plane = No Jobs**” places an immediate laser focus on the new international gold standard of the 21st century...**JOBS**. (If memory serves correctly, wasn't the No Plane No Gain phrase a title of a study conducted by the former international CPA firm, Arthur Andersen & Co? Didn't that study conclude that the greatest percentage of companies listed on the NYSE used private aircraft?)

The aircraft manufacturers could do a lot more to help their own cause. Adding to the skill sets of their sales and marketing employees, referring to their customers as clients, setting up formal order preservation procedures and making more efficient use of their own in-house professional staff could go a long way towards preserving jobs for their own employees. In this “Needs” based economy, new advertising and marketing campaigns have to become more sensitive to the fact that many Americans are having a hard time putting food on the table. Query: Does an advertisement that shows an ostentatious, wildly extravagant aircraft interior with a rack of crystal champagne glasses, a half filled glass of wine on a conference table accompanied by a model sporting a \$10,000 custom tailored suit really portray the image of a serious working business aircraft? How many business employees would be paid to drink on company time while they were supposed to be on the way to an important meeting? Let's start using some common sense in this industry and stop being our own worst enemy. By the way, IRS agents see these ads also!

The example of what a corporation president did to his company as a result of a knee jerk, panic decision to dispose of the company aircraft speaks for itself.

Time is of the essence. If the industry is going to implement any of the suggestions in this article, sooner rather than later is advisable. Increasing tax rates for many are coming in 2011. Current debt levels are clearly unsustainable. Some economists are already speculating as to a double-dip recession in 2011. If that happens, it will be much worse than the first installment. It is one thing to begin a recession with a 5.5% unemployment rate. It is a far different proposition to enter a recession with a 10% unemployment rate. Some counties in California already have a published unemployment rate of 25%. Even if we are fortunate to avoid a double-dip, I suspect that 10% or higher unemployment rates in many states will continue for years to come unless our GDP increases every year for the next ten years at a sustained rate of at 6.5% - 7%. We will need at least that rate of sustained growth to put all of the under employed, unemployed and those who have quit looking back to work.

For those of us who use our airplanes for business purposes, that will remain the transportation method of choice at least until the high tech nerds figure out a way to literally beam individuals to business meetings or email a handshake.

ATIS Group LLC:

ATIS Group LLC, **A**viation **T**ax **I**nformation **S**ervices Group, has specialized in providing aviation tax advice since the mid 1980s. We “pioneered” the California Interstate or Foreign Commerce Use Tax Exemption for aircraft with our own airplane in 2001. In addition to serving small, medium and NYSE listed companies in the areas of federal and state income, sales, property and excise taxes issues we also provide IRS audit support services to CPA and law firms and their clients throughout the country. Expert witness services are also provided. ATIS Group stands ready to assist manufacturers to develop in-house aircraft business consultant programs and offer suggestions for aircraft exterior and interior improvements. Perhaps we can work together on some performance modifications to ensure that tomorrow’s business aircraft can greatly assist their owners in providing more JOBS for this 21st century economy.

Lastly, ATIS Group, LLC would like to thank Rich Manor at Pacific Air Center in Long Beach, California for his insight and comments for this article. You may contact Mr. Manor at (562)413-3251 or www.pacificaircenter.com .