

ATISJETS AIRCRAFT TAX ALERT OCTOBER 26, 2004

EXTENSION OF BONUS DEPRECIATION - ATTACK on PERSONAL AIRCRAFT USE

On October 22, 2004 the President signed the American Jobs Growth Act of 2004. For the general aviation industry, the law provides one year of additional time, i.e., until December 31, 2005, to place FAR Part 91 aircraft into service and still be eligible for Bonus Depreciation. **(Unfortunately many new aircraft used in FAR Part 135 operations will not qualify for the 1-year extension of time to be placed in service because of a “gap” in the law. The only aircraft used under FAR Part 135, 125 or 121 that will qualify are those aircraft which have a production period in excess of two years or which cost in excess of 1 million and also have a production period in excess of 1 year per I.R.C. § 168 (k)(2). Many popular aircraft, which are currently used in FAR Part 135 service, will not be able to meet the cost and production period tests. Furthermore, the new law applies to new equipment such as RVSM equipment unless that equipment is installed and placed in service on or before December 31, 2004).**

In order to take advantage of the new law the following must occur.

1. Sign a purchase agreement before December 31, 2004
2. The buyer must make a down payment equal to the lesser of \$100,000 or 10% of the purchase price
3. The aircraft must cost at least \$200,000 and have an estimated production period of 4 months.

ATTACK on PERSONAL USE

The new law specifically states that its purpose is to “overturn the Sutherland Lumber-Southwest, Inc. v. Comm. 114T.C. 197 (2000), aff’d, 255 F.3d 495 (8thCir.2001), acq., AOD 2002-02 (Feb. 11, 2002).

This means that as of October 22, 2004 deductions for personal use are limited to the amount of compensation included as income by using the SIFL , Standard Industry Fare Level, rates to compute the value of the personal use. This limitation will be in effect until it is reversed by legislation, if ever.

Accordingly, personal use will be very expensive on business turboprops or jets. Because of these legislative changes, personal travel during the approaching holiday season will make this season the most expensive on an after tax basis in several years.

Obviously, the annual business use factor is the most important calculation to be made in connection with the operation of a business aircraft. (If you need assistance with that, please call me at 661-269-9441).

EXAMPLE: Assume that depreciation, fuel, insurance and other aircraft deductions for 2005 are \$2,000,000 at 100% business use. However, the aircraft was only used 60% for business trips and 40% for personal executive vacations with a S.I.F.L. rate value of \$25,000 during the year for the vacation flights.

Under the new law, the deductions for depreciation, operating and non-operating expenses would amount to \$1,200,000 for 60% business trips, plus an additional \$25,000 for the value of the personal use imputed to the executive's W-2. Overall, the business entity would lose \$775,000 in deductions for depreciation and other expenses because of personal aircraft use. At a 35% tax rate, that amounts to a cost of \$271,250 in additional taxes. **Therefore, personal use will be very expensive at any level for years to come unless there is another legislative change for those specific provisions.**

Prior to October 22, 2004, Sutherland Lumber - Southwest vs. Commr.U, 114 T.C. 197, and a general counsel memorandum provided that if a business aircraft was used for personal use such as executive vacations, golf outings, etc., and the value of the personal use is computed using the Standard Industry Fare Level (S.I.F.L.) tables and added to the executive's personal income, the aircraft may still be depreciated as if it were used 100% for business.

Operating and non-operating expenses may also be deducted at the 100% level even though business use is only 5% per Chief Counsel Advice ILM 200344008 dated July 1, 2003.

The Chief Counsel's opinion was viewed as "giving away the farm" by many within the Internal Revenue Service, tax advisors, many in the general aviation industry and especially a number of our elected representatives in the U.S. Senate and House of Representatives.

Observation: In as few as 2-3 years, with only a personal use factor of 5%-10%, the amount of bonus depreciation "benefits" enjoyed by a relative handful could be eclipsed by the loss of deductions for personal aircraft use as provided by the law prior to October 22, 2004. This is true because the restrictions on personal use now apply to every business aircraft. Even aircraft that have long since been fully depreciated will lose a portion of their deductions for fuel, insurance or other expenses. Whether the aircraft is the newest intercontinental wide body business jet or the oldest single engine piston aircraft, as long as there is any element of personal use, deductions will be lost

If personal use is not tracked and accurately accounted for at least quarterly, CEOs, CFOs, and others may be at risk of incurring personal and corporate liability.

CORPORATE LIABILITY

While the most obvious cost of personal aircraft use may be loss of tax deductions, the greatest cost may be in the form of loss of public confidence in the accounting procedures used by public and private companies who own and operate business aircraft.

On June 30, 2002 Congress passed the American Competitiveness and Corporate Accountability Act of 2002, more commonly referred to as Sarbanes-Oxley Act. For the most part the provisions of Sarbanes-Oxley were directed at restoring investor confidence in public companies as a result of corporate accounting scandals.

Standards for conduct of auditors, board members and corporate management are a central thrust of the regulations. One of the requirements of the Act is for the chief executive officer and chief financial officer to personally certify and attest to the accuracy and fairness of the financial statements. Additionally, the chief executive officer must also sign the tax return.

In order to avoid potential corporate or personal liability, aircraft owners should carefully track and account for personal use, at least on a quarterly basis, in order to ensure that the quarterly estimated tax payments are correct and to avoid claiming too much depreciation and other aircraft expense deductions on their tax returns. If the tax return is inaccurate, it is very likely that the provision for federal and state income taxes will be incorrect. It then follows that the financial statements will be inaccurate along with reports filed with the Securities and Exchange Commission. If the above reports are incorrect, the chief executive and financial officers may be subject to criminal sanctions, in addition to the stock market's loss of confidence in the company overall.

Even though public companies are the focus of Sarbanes-Oxley, private companies may also want to hold themselves to the higher standards of conduct because:

1. The standards constitute good business practice.
2. The private company may want to go public in the future.
3. The private company may want to position itself to be acquired by a public company.
4. The private company may want to become involved in an initial public offering, IPO.
5. Lenders may require private companies to adhere to various provisions before a loan will be granted.

If any of these courses of action are being considered, I recommend consulting your independent CPA firm to determine your company's status vis-à-vis Sarbanes - Oxley.

SUMMARY

Many in the industry are beginning to realize that the temporary advantages for the U.S. General Aviation Industry provided by the American

Jobs Growth Act of 2004 are far outweighed by the severe and permanent restrictions imposed upon personal use of business aircraft. Even a small amount of personal use could jeopardize millions of dollars in deductions for depreciation, operating and non-operating expenses.

As always, AtisJets Acquisitions & Tax Services LLC stands ready to assist aircraft owners in deriving the maximum tax benefit as a result of their aircraft investment.

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