

FALL / WINTER 2015

Florida *aviation* b u s i n e s s

Click or Drag to Zoom

BUSINESS ASSOCIATION SERVING THE GENERAL AVIATION COMMUNITY SINCE 1946

FABA: The Little Engine That Could

Embry-Riddle's Electric Flight Program Soaring

Airplane Taxes in a nutshell



Click or Drag to Zoom

Airp in



Plane Taxes a Nutshell

By Sue Folkinga, CPA, ATP

TYPICALLY, EARLY ON IN THE PURCHASE process, an astute aircraft buyer will seek out professional advice to be sure he/she understands if there will be tax assessed on the purchase, and if so, how that tax can be minimized or avoided. Someone new to the world of aviation will rely on their newfound contacts to **Click or Drag to Zoom** as sales taxes and income taxes. An aviation professional, as well as an aircraft purchaser, could benefit from knowing a few tax basics. There are seven sections of the US Tax Code that deal specifically with aircraft, and we'll briefly describe those here. Most states have sales or use tax that could apply to an aircraft purchase, so we'll keep this part general, with special emphasis on Florida Sales and Use taxes.

1) Ordinary and Necessary

Travel expenses while away from home on business, other than those amounts that are lavish or extravagant, are deductible. When this issue comes up in an IRS audit, we need to show that the aircraft is incidental to the company's business and not merely an expensive perk for the benefit of the owners and company executives.

In an audit, the IRS could limit the deductibility of the aircraft expenses by computing the equivalent cost of first-class airfare, which would be much less than the actual aircraft expenses. Just because a company can afford private transportation does not guarantee it is a deductible expense. Typically, we need to prove three things: air transportation is required, air transportation may only be met by private aircraft, and the aircraft used is appropriate in meeting the transportation needs of the company.

2) Hobby Losses

Oftentimes, aircraft are owned in a company that stands alone: the cash coming into the company is owner contributions to pay the expenses of the aircraft, and the company consistently shows losses due to depreciation. Because there are no profits, these companies can be targets of IRS audits, since the company cannot meet the IRS codified safe harbor of showing a profit in three out of five years.

A "hobby loss" case can be a big win for the IRS, since all costs associated with the aircraft will be disallowed. Successful defense of this type of audit comes from showing how the aircraft company supports the business purpose of a group of entities.

3) Passive Loss Limitations

If your aircraft will be rented, leased or chartered, and you as the owner don't "materially participate" in the endeavor, the income or loss from this activity could be considered "passive." As a result, losses, which are typical for aircraft due to the large amounts of depreciation deducted, could be deferred for future years to be offset by passive income or utilized when the aircraft is ultimately sold.

This is an area that requires planning and strategizing before the activity is started in order to get the best tax advantage. Each individual and/or company has different tax goals that need to be explored before renting takes place.

4) Personal Use

For non-business flights on an aircraft owned by a corporation, S-Corp or partnership and provided with a pilot, employees of the company must report *Standard Industry Fare Level* (SIFL) taxable income. The company must apply the *Entertainment Cost Disallowance* rules to expenses if there were entertainment flights provided to "specified" individuals—those who can direct the movements of the aircraft.

Careful documentation of the flights of a business aircraft are key to supporting the deduction of expenses by the company, and computation of the SIFL charge is a small price to pay compared to the exclusion of expenses for personal flights.

5) Depreciation

Some of the depreciation problems we see in practice are non-compliance with the *Listed Property* rules, incorrect application of depreciation rates, failure to follow the tax-free exchange (§1031) rules and failure to follow the bonus depreciation rules.

In general, to deduct depreciation, an aircraft has to be used in a trade or business. In order to deduct *accelerated* depreciation for an aircraft, the aircraft must be used more than 50 percent in a trade or business. Accelerated does not mean you will deduct more depreciation; it just means you will deduct more in the early years of ownership.

Bonus depreciation rules have changed over the years, so check on this before you count on a certain deduction. Currently, no bonus depreciation is available for 2015, however Section 179 depreciation is available, which is another way to potentially deduct more depreciation in the year of purchase.

6) Flight Department Company and FET

If an entity owns and operates an aircraft, pays the direct operating costs of the aircraft and pays the pilots of the aircraft, the IRS would consider this to be a company that provides air transportation, and in that case, the agency would have to charge Federal Excise Tax. This tax is charged to each passenger at a rate of 7.5 percent on the costs of flight, and there is a flat-rate "segment fee." The tax is the same tax you would pay if you boarded an airline for a flight,

but unlike an airline, a business does not have the administrative horsepower to administer the filings.

Restructuring your company to move the pilots to a separate company and put "dry leases" in place is often used as a strategy to guard against this situation.

7) Sales Tax

Every state is different, but in general, states that have sales and use taxes assess tax on the purchase of property by residents and businesses. In general, sales tax is due on the purchase of aircraft, or use tax is due on the use (leasing) of an aircraft unless an exemption applies. In either case, sales or use tax planning prior to a purchase or commencement of a lease is critical to success in taking advantage of the exemptions available.

There are two important aspects of state sales tax: 1) what is your or your company's connection to the state and 2) where is the purchase taking place? Airplane owners are often surprised to receive a notice from the state where an aircraft purchase took place only to learn they did not comply with the specifics of an exemption. The burden of proof is with



"We could use a Guardian Angel in accounting."



LANDMARK AVIATION
FBO • MRO • Aircraft Management & Charter



Offering More Convenience with Six Florida Locations.

Miami (MIA) • Opa-Locka (OPF) • Pahokee (PHK)
Tamiama (TMB) • Tampa (TPA) • West Palm Beach (F45)

888.362.6738 | www.landmarkaviation.com

the taxpayer. For example, many states have a fly-away exemption available to non-residents, which means sales tax in that state will not apply if the aircraft is purchased and flown out of the state within a short period of time after the sale. The time you have to fly the aircraft out of the state is always defined in the state's regulations so it's important to find this out before the transaction takes place. Florida regulations specify removal of the aircraft from Florida within 10 days unless the aircraft is immediately placed in a registered repair facility.

FABA and NBAA are working with lawmakers to get an aircraft sales tax exemption passed in Florida. This would change the landscape for both buyers of aircraft and those associated with aircraft transactions. Stay tuned!

Note that not all of the tax issues mentioned here will apply to every transaction, since each owner and operation is different, but knowing the issues well enough to ask the right questions is key to planning and minimizing your tax burden.

By Sue Folkringa, CPA, ATP, is an Aviation Taxologist with Wolcott & Associates, P.A.