

# CLIENT UPDATE



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## BONUS DEPRECIATION EXTENDED AS PART OF THE 2009 STIMULUS PACKAGE

The American Recovery and Reinvestment Act of 2009 (the “Stimulus Package”) includes some good news for prospective aircraft buyers.

Bonus Depreciation benefits have been extended for another year. This article will explore and summarize Bonus Depreciation and will examine some practical considerations for taking advantage of the extended benefit.

Before exploring how Bonus Depreciation may benefit aircraft owners, let’s examine a few misconceptions about Bonus Depreciation. First, the term “Bonus Depreciation” is a bit of a misnomer. Bonus Depreciation eligible assets do not generate “more depreciation” than non-eligible assets. Bonus Depreciation merely entitles the owner of an eligible asset to realize depreciation benefits more quickly. Simply stated, Bonus Depreciation is “faster depreciation” not “more depreciation.” We will demonstrate how this works later in this article. A second misconception, fueled of late by the media, is that Bonus Depreciation is a “business aviation benefit.” Not true. Bonus Depreciation is available for a wide variety of capital assets.

What then is Bonus Depreciation? Briefly stated, 50% of the cost of Bonus Depreciation eligible property may be deducted in the year the property is acquired. The remaining 50% of the cost or “basis” remains eligible for depreciation in future years according to normal depreciation rules.

In order to be Bonus Depreciation eligible, an asset must be MACRS property. This means that property used less than 50% of the time for business purposes and property used predominantly outside the United States will not be eligible for Bonus Depreciation. In addition, in

order for an asset to be eligible for Bonus Depreciation, the asset must be “new.”

To illustrate the benefit of Bonus Depreciation, assume that Taxpayer A acquires a new aircraft for \$10,000,000. Without Bonus Depreciation, Taxpayer A’s depreciation schedule for the aircraft will be as follows:<sup>1</sup>

### FIVE-YEAR MACRS PROPERTY WITHOUT 50% BONUS

YEAR	PERCENTAGE DEDUCTION	DEPRECIABLE BASIS	DEPRECIABLE AMOUNT
1	20.00 x	\$10,000,000	= \$2,000,000
2	32.00 x	\$5,000,000	= \$3,200,000
3	19.20 x	\$10,000,000	= \$1,920,000
4	11.52 x	\$10,000,000	= \$1,152,000
5	11.52 x	\$10,000,000	= \$1,152,000
6	5.76 x	\$10,000,000	= \$576,000
<b>TOTALS:</b> 100.00			\$10,000,000

Now assume that Taxpayer A acquires the same \$10,000,000 aircraft but that the aircraft is Bonus Depreciation eligible. Taxpayer A’s depreciation benefits will be as follows:

### FIVE-YEAR MACRS PROPERTY WITH 50% BONUS

YEAR	PERCENTAGE DEDUCTION	DEPRECIABLE BASIS	DEPRECIABLE AMOUNT
Bonus (Yr. 1)	50.00 x	\$10,000,000	= \$5,000,000
1	20.00 x	\$5,000,000	= \$1,000,000
2	32.00 x	\$5,000,000	= \$1,600,000
3	19.20 x	\$5,000,000	= \$960,000
4	11.52 x	\$5,000,000	= \$576,000
5	11.52 x	\$5,000,000	= \$576,000
6	5.76 x	\$5,000,000	= \$288,000
<b>TOTALS:</b> 100.00			\$10,000,000

<sup>1</sup>The Tables provided illustrate the benefit of depreciation and Bonus Depreciation for a “non-commercial” aircraft depreciated on a five-year schedule. “Commercial” aircraft, generally including aircraft used predominantly in charter service, will be depreciated over a longer seven-year schedule. The levels of depreciation in each year will be lower for seven-year property, but the impact of Bonus Depreciation will be similar and the aircraft will remain eligible for depreciation benefits equal to 100% of the cost of the aircraft.

As the tables illustrate, Bonus Depreciation provides dramatic tax benefits in the year that an asset is acquired and results in lower levels of benefits in the following years. Nevertheless, the total depreciation benefit over the depreciable life of the aircraft remains the same.

Bonus Depreciation may also prove a valuable tool for aircraft owners who are acquiring assets other than whole aircraft. The Temporary Regulations specifically note that fractional aircraft interest purchases can qualify for Bonus Depreciation. Current large fractional interest inventories make acquisition of a qualifying fractional interest relatively easy to complete. Note, however, that in order for a fractional interest to qualify, there can not have been any previous owner of the share other than

the fractional program itself. In addition, Bonus Depreciation may prove valuable for taxpayers making capital acquisitions related to their aircraft, such as tugs, engine replacements or major avionics or interior upgrades.

Let's now turn our attention to what makes an aircraft or other asset "qualifying property" for Bonus Depreciation purposes. The Stimulus Package sets forth specific criteria for "qualifying property."

Only those aircraft whose original use commences with the taxpayer in or after 2008 or 2009 are eligible for Bonus Depreciation. In addition, the aircraft must be "placed in service" prior to the end of 2009. There are some limited extensions of the 2009 placed in service date for "transportation property" and "certain aircraft." Furthermore, only aircraft for which there was "no written binding contract for the acquisition ... in effect before January 1, 2008" or for which "a written binding contract ... was entered into" in 2008 or 2009 will qualify for Bonus Depreciation. In previous years long delivery backlogs made it extremely difficult to find an aircraft which could meet both the contract formation and placed in service requirements. However, the current economic slowdown may free up many previously sold out delivery positions. As a practical matter, it is now possible to enter into a contract this year and still meet the relatively short placed in service deadlines.

The Stimulus Package extends the placed in service date through 2010 for two types of aircraft, "transportation property" and "certain aircraft." The statute and regulations do not provide much guidance as to what constitutes "transportation property" other than to say that "transportation property" includes tangible personal property used in the trade or business of transporting persons or property. Presumably, this would include an aircraft that is used predominantly for charter missions, but it is unclear if an aircraft used less than half the time in charter service would qualify. Although the placed in service date is extended through 2010 for transportation property, the Bonus Depreciation benefit is limited "only to the extent of the adjusted basis attributable to manufacture, construction or production before January 1, 2010."

The placed in service requirement is also extended through 2010 for "certain aircraft." "Certain aircraft" are defined as aircraft which are not "transportation property," which cost more than \$200,000 and have an estimated production period exceeding four months. Virtually all jets and turboprops meet these criteria. In addition, at the time of contract for purchase, the purchaser is required to make a nonrefundable deposit of the

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lesser of 10% of the cost or \$100,000.

Note should be taken of the fact that although the placed in service date is extended through 2010 for “transportation property” and “certain aircraft,” the other Bonus Depreciation eligibility requirements still apply. Thus, for example, a charter aircraft contracted for in 2007 would not, absent another exception to the general rules, qualify for Bonus Depreciation.

It appears that aircraft which would not have qualified for Bonus Depreciation prior to the enactment of the Stimulus Package due to later placed in service dates may benefit from the extended placed in service dates in the Stimulus Package. For example, an aircraft contracted for in 2008 which is neither “transportation property” nor a “certain aircraft” scheduled to be placed in service in 2009 would not have qualified for Bonus Depreciation. With the extensions of placed in service dates in the Stimulus Package, these aircraft will now qualify for Bonus Depreciation in 2009.

“Self constructed property” is granted some relief from the requirement that there be no written binding contract in place at the beginning of 2008 if the manufacture, construction or production of the property begins in 2008 or thereafter. The Temporary Regulations include within the definition of “self constructed property” “property that is manufactured, constructed or produced for the taxpayer by another person under a written binding contract that is entered into prior to the manufacture, construction or production of the property for use by the taxpayer...” As few new aircraft are being built on spec, many business aircraft would seem to meet this criteria. In order to qualify, the production of the aircraft would have to begin in or after 2008 and be completed by the end of 2009. The Temporary Regulations state that “construction of property begins when physical work of a significant nature begins” and that “physical work of a significant nature will not be considered to begin before the taxpayer incurs or pays... more than 10 percent of the total cost of the property” or the taxpayer is able to demonstrate qualification under the “facts and circumstances” of their situation. Therefore, aircraft whose production begins in 2008 or 2009 or for which only small payments were made or relatively minor amounts of work completed prior to the beginning of 2008 may qualify for Bonus Depreciation as self-constructed property.

Due to historically long delivery backlogs, the “written binding contract” requirement prevented many new aircraft contracts from qualifying for Bonus Depreciation. For example, absent another exception to the general rules, an aircraft contracted

for in 2007 would not qualify for Bonus Depreciation even if placed in service in 2009. However, the Temporary Regulations define “written binding contract” in a manner which might allow many older aircraft contracts to qualify for Bonus Depreciation. If, upon breach of the contract by the seller/manufacturer, the contract provides for a full refund of the purchase price in lieu of any other damages allowable by law, the contract is not considered to be a “written binding contract.” Many new aircraft contracts have provisions which limit a buyer’s remedy to a refund of any progress payments made. Although both the buyer and seller in a new aircraft contract will no doubt consider that they have an effective and binding contract, the Temporary Regulations may allow the buyer to reach the conclusion that the contract is not “binding” within the meaning of the statute. Such aircraft may qualify for Bonus Depreciation.

How does Bonus Depreciation impact holders of delivery positions who wish to sell their positions and buyers of such positions? With long manufacturing periods and large delivery backlogs, it has become a fairly common practice for persons to enter into new aircraft contracts with the intention of selling their positions to potential end users. The current economic slowdown has caused many taxpayers with aircraft delivery positions entered into in prior years to reevaluate their need for a new aircraft and to consider the sale of their delivery positions.

There are a variety of methods used to accomplish the sale of an aircraft delivery position including, sales of interests in an LLC which owns a delivery position, assignments of the purchase

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contracts, so-called “back-to-back” transactions and eventual resales of a newly acquired aircraft. Taxpayers should be aware that the Service may challenge the eligibility for Bonus Depreciation of such transactions as these transactions seem to fall outside of the stated Congressional and Presidential intentions of stimulating the production and sale of new capital assets. The success or failure of any such challenge is likely to hinge on the particular facts and circumstances and the method of documentation of each transaction. An examination of the various types of assignments and the availability of Bonus Depreciation is beyond the scope of this article, but anyone considering such a transaction should do so with an awareness that they are taking an aggressive reporting position and are relying upon interpretation of the legislation in such a way that runs counter to the stated purpose behind the adoption and extension of Bonus Depreciation.

Sale leaseback and syndication transactions continue to enjoy favorable treatment provided by the Temporary Regulations. Aircraft originally placed in service by an end user and sold to a leasing company and leased back to the end user within three months after the original placed in service date remain eligible for Bonus Depreciation. Aircraft sold from one leasing company to another within three months of the original placed in service date remain eligible for Bonus Depreciation in the hands of the second leasing company. In addition, it is possible to “stack” a sale-leaseback and syndication transaction such that the syndication transaction may occur up to six months after the original acquisition of the aircraft.

In conclusion, the Stimulus Package provides some significant benefits for purchasers of new business aircraft.

This article has highlighted some of the strategies for taking Bonus Depreciation on a new

aircraft purchase. The reader is cautioned that this article is not intended to be more than an introduction to the topic. Anyone considering taking Bonus Depreciation benefits for a new aircraft should not only read the law and Temporary Regulations, but should also retain independent legal, tax and accounting advice to determine if their aircraft is eligible for Bonus Depreciation and to properly structure their acquisition.

*If you have any additional questions regarding this Update or have any other Corporate & Business needs, please contact any member of the Group.*

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