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Stimulating Stimulus for New Private Aircraft Buyers

In February, the Federal government passed the Economic Stimulus Act of 2008 in an attempt to stimulate the economy by encouraging consumers to spend. Average consumers get checks - \$1,200 per couple plus \$300 per child. Wealthy consumers do not get checks, but instead will be enjoying windfall tax deductions potentially worth millions.

The stimulus law allows taxpayers to take a 50% “bonus” depreciation on new aircraft purchases. Essentially, 50% of the cost of brand new business aircraft purchased in 2008 and placed in service in 2008 (extended through 2009 for certain aircraft) can be deducted in the year acquired, plus the purchaser can still also take normal depreciation deductions. So, if you buy a \$10 million business jet in 2008, you could have a \$6 million tax deduction in that first year of ownership. AND, if the aircraft’s purchase was financed, the interest on the loan can be deducted. AND, its also possible to defer taxable gain on the sale of a currently owned aircraft at the same time through a Section 1031 like-kind exchange. All in all, significant benefits for purchasing an aircraft, but there are a few hurdles.

First, the “original use” of the aircraft must begin with the taxpayer – that is, it cannot be a used

aircraft (other than certain sale/leaseback situations occurring within 3 months of the aircraft’s original use). However, if you are buying a fractional interest in an aircraft from an aircraft fractional program, such a Flexjet or NetJet, then the original use begins with the first user of each fractional interest in the aircraft, so each fractional owner will be considered the original user of its proportionate interest in the aircraft.

Second, your binding written contract for the aircraft cannot have been signed prior to January 1, 2008. So, if you are scheduled to have a new aircraft delivered in 2008, but signed the contract with the aircraft manufacturer in 2006, then you will not qualify for the bonus depreciation. The reason for this is that the bonus depreciation is to stimulate spending – but there is no economic stimulation if the decision to purchase was made two years ago, with delivery just happening to occur during 2008/2009.

What to do? First thing to consider is whether you really have a “binding written contract” for the aircraft, as the IRS might consider those words. In prior Tax Regulations, a contract is binding only if it is enforceable under state law against the taxpayer or a predecessor, and does

not limit damages to a specified amount (for example, by use of a liquidated damages provision). For this purpose, a contractual provision that limits damages to an amount equal to at least 5% of the total contract price will not be treated as limiting damages to a specified amount. Therefore, an existing contract to purchase an aircraft that has a liquidated damages provision of less than 5% may not be considered a binding contract and could still be eligible for bonus depreciation.

There are other options to consider, such as flips and swaps, but these are more complicated and subject to deeper IRS scrutiny. With a flip, you would arrange to purchase the new aircraft from a person that already is scheduled to take possession of the aircraft during 2008/2009. If you have a pre-existing binding written contract

with delivery in 2008/2009, you can try to find another person in the new aircraft delivery queue for a swap. With both flips and swaps, you should make sure that the original use of the new aircraft is with you and that the other party to the transaction is unrelated (as defined by the IRS).

Ironically, the structure of the stimulus package does not exactly encourage manufacture of new business aircraft, but it certainly encourages the desire to purchase new aircraft already scheduled to be built.

For more information, please contact Gary Horowitz at 301-800-0001, or ghorowitz@hchlegal.com.