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Internal Revenue Service  
Room 5203  
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Washington, DC 20044

Submitted via [www.regulations.gov](http://www.regulations.gov)

**RE: IRS REG-168745-03: Guidance Regarding Deduction and Capitalization of Expenditures Related to Tangible Property; Proposed Rule**

The National Business Aviation Association (NBAA) represents the interests of more than 9,000 Member companies that rely on general aviation aircraft to help make their businesses more efficient, productive and successful. We appreciate the opportunity to submit these comments on behalf of the business aviation community.

The following general discussion of the operational and regulatory aspects of aircraft is provided as background information.

**Aircraft Operations**

All civil aircraft operations in the United States must be conducted in accordance with the Federal Aviation Administration (FAA) rules, including the Federal Aviation Regulations (FARs).<sup>1</sup> The FARs classify aircraft operations into various categories including: (1) airline operations conducted under Part 121 of the FARs; (2) charter operations conducted under Part 135; and (3) noncommercial operations conducted under Part 91. Our greatest concern is with the business aviation community, "general aviation aircraft" operated under Parts 91 and 135. This includes aircraft operated under a fractional ownership program - where several owners (or lessees) share their aircraft with other owners (or lessees) and the aircraft in the program are managed by an aircraft management company.

General aviation aircraft usage averages 400 hours per year and can vary widely – anywhere from 200 flight hours per year for a business aircraft to over 1200 hours per year for an aircraft that is part of a fractional ownership program. In contrast, airline aircraft usage can be in excess of 3,000 flight hours per year.

**Inspection and Maintenance Programs**

The FARs require the operator of a general aviation aircraft to maintain the aircraft in accordance with specified standards. At a minimum, a Part 91 aircraft must have an annual inspection and/or a 100 hour inspection. In addition, certain parts of the aircraft, such as the altimeter system and transponder, must be inspected at prescribed intervals. Larger Part 91 aircraft and Part 135 aircraft are subject to a regular series of inspections, called progressive inspections. For example, the owner of a Cessna Citation aircraft will perform a series of inspections, known as Phase 1 through 5.

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<sup>1</sup> 49 U.S.C. § 40103; 14 C.F.R.

The cost of merely inspecting the aircraft can be significant. However, an inspection does not necessarily involve the repair or replacement of any parts. In many cases, the job of the inspector is to determine whether parts are within tolerance and to look for corrosion, cracks or unusual wear and tear. This may take several days and require inspecting hundreds of parts.

### **Aircraft Repairs and Overhauls**

An aircraft operator may repair and replace parts for several reasons. The parts may have broken or have reached the end of their replacement interval. The inspection may have revealed that the parts are out of tolerance. The manufacturer may have instituted a program requiring or encouraging the replacement of certain parts for safety purposes. The replacement parts may be new, used or reconditioned parts, ranging in price from under \$10 to more than \$250,000. In many cases, the aircraft owner will have to overhaul the part. For example, in contrast with other transportation property, such as an automobile, an aircraft owner will have to overhaul the engines several times during the life of the aircraft. The owner of an airline aircraft might overhaul the engines every 2 years, while the owner of a general aviation aircraft might overhaul the engines every 5 to 10 years. Nevertheless, in both cases, the general procedures involved are essentially the same.

## **1. ROUTINE MAINTENANCE SAFE HARBOR**

In comments submitted on the previous Proposed Regulations, we noted that aircraft may have a 12 year class life (commercial) or a 6 year class life (noncommercial).<sup>2</sup> The temporary and proposed regulations contain the same "safe harbor" that allows taxpayers to currently deduct the cost of "routine maintenance."<sup>3</sup> "The activities are routine only if, at the time the unit of property is placed in service by the taxpayer, the taxpayer reasonably expects to perform the activities more than once during the class life . . . ."<sup>4</sup> Example 1 discusses engine shop visits of a Part 121 airline aircraft with a class life of 12 years.<sup>5</sup> Under IRS guidelines, Part 135 operated aircraft are generally commercial with a 12 year class life, but Part 91 operated aircraft are generally noncommercial with a 6 year class life, as are all helicopters. A Part 135 aircraft and a Part 91 aircraft may be the exact same make and model. To further complicate this issue, the FAA Modernization and Reform Act of 2012 (P.L. 112-95) makes fractional aircraft noncommercial, regardless of whether they are operated under Part 135 or Part 91.<sup>6</sup>

A commercial aircraft is more likely to have more use and need cyclical scheduled maintenance more often during its 12 year class life while the same model noncommercial aircraft may not meet the safe harbor simply because of the shorter designated 6 year class life. As a result, a noncommercial general aviation aircraft owner may be unable to take advantage of the safe harbor - even though the expenses are identical to those that might be covered in the case of an identical model "commercial" aircraft.

Of particular concern is the inconsistent treatment of aircraft engine overhauls. In the case of commercial aircraft, an engine overhaul could generally qualify for the routine maintenance safe harbor. In the case of noncommercial aircraft, engine overhauls may not qualify for the routine maintenance safe harbor due

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<sup>2</sup> Rev. Proc. 84-56, Asset Class 45.0 [generally commercial aircraft] and Asset Class 00.21 [generally noncommercial aircraft and all helicopters].

<sup>3</sup> Prop. and Temp. Treas. Reg. § 1.263(a)-3T(g).

<sup>4</sup> Prop. and Temp. Treas. Reg. § 1.263(a)-3T(g)(1).

<sup>5</sup> Prop. and Temp. Treas. Reg. § 1.263(a)-3T(g)(5), *Example 1*.

<sup>6</sup> H.R. 658, Section 1103(b) (amending I.R.C. § 4083(b), effective April 1, 2012.

to the shorter class life of noncommercial aircraft.<sup>7</sup> Since the exact same aircraft could be used for either commercial or noncommercial purposes, this disparity in the treatment of engine overhaul expenses between commercial and noncommercial aircraft is an arbitrary distinction.

We have read the preamble to the Temporary Regulations and understand and appreciate the IRS's effort to create a bright line class life rule. However, to avoid these inequities and problems and maintain the desired bright line rule, we propose that you modify the definition of class life to allow all aircraft to use the same 12 year class life as follows:

At the end of Prop. and Temp. Treas. Reg. § 1.263(a)-3T(g)(4), add the following new sentence:

If the unit of property has more than one possible class life depending on its use, the taxpayer may elect to apply this safe harbor using the longest such possible class life.

## 2. REPAIRS TO USED AIRCRAFT

### a. Amelioration of Prior Existing Material Condition or Defect

The temporary and proposed regulations, like the prior proposed regulations, prescribe a special rule for purchasers of used property that will create significant problems for purchasers of used aircraft. In determining whether an expenditure is a betterment or a repair, the proposed and temporary regulations have adopted the "Plainfield Union Test"<sup>8</sup> as the general rule for "appropriate comparison."<sup>9</sup> This proposed and temporary regulation provides that, in general—

the determination of whether an expenditure results in a betterment of the unit of property is made by comparing the condition of the property immediately after the expenditure with the condition of the property immediately prior to the circumstances necessitating the expenditure.

However, the regulations go on to modify this test by providing that the appropriate comparison for reparation of normal wear and tear, where a taxpayer purchases used property, shall be the following:

If the expenditure is made to correct the effects of normal wear and tear to the unit of property (including the amelioration of a condition or defect that existed prior to the taxpayer's acquisition of the unit of property resulting from normal wear and tear), the condition of the property immediately prior to the circumstances necessitating the expenditure is the condition of the property after the last time the taxpayer corrected the effects of normal wear and tear (whether the amounts paid were for maintenance or improvements) or, if the taxpayer has not previously corrected the effects of normal wear and tear, the condition of the property when placed in service by the taxpayer.<sup>10</sup>

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<sup>7</sup> Prop. and Temp. Treas. Reg. § 1.263(a)-3T(g)(5), *Example 7*.

<sup>8</sup> *Plainfield-Union Water Co. v. Comm'r*, 39 TC 333 (1962), *nonacq.* 1964-2 C.B. 8.

<sup>9</sup> Prop. and Temp. Treas. Reg. § 1.263(a)-3T(h)(3)(iii)(A).

<sup>10</sup> Prop. and Temp. Treas. Reg. § 1.263(a)-3T(h)(3)(iii)(B).

This modification with regard to normal wear and tear from a prior owner's use is subject to the materiality threshold presented in the general definition of a "betterment."<sup>11</sup> However, the provisions quoted above are confusing, because they do not repeat the "materiality" condition from the definition of "betterment."

This confusion can be alleviated by inserting a reference to material conditions or defects at the end of Prop. and Temp. Treas. Reg. § 1.263(a)-3T(h)(3)(iii)(B), so that it reads:

if the taxpayer has not previously corrected the effects of normal wear and tear, the condition of the property when placed in service by the taxpayer **taking into consideration only material conditions or defects.**

#### **b. Regular Maintenance on Used Aircraft**

The above materiality concept is illustrated in Prop. and Temp. Treas. Reg. § 1.263(a)-3T(h)(4), *Example 3*, in which regular maintenance expenditures by the purchaser of a used machine did "not ameliorate a material condition or defect" based on the facts and circumstances including the "purpose and minor nature of the work performed." In contrast, in *Example 5* repairs and maintenance were performed on a building that was below standards for an assisted living facility at the time the building was purchased. These repairs and maintenance improved the building to the high-quality condition necessary for an assisted living facility. Since the improvements ameliorated material conditions or defects in existence at the time of purchase, the expenditures had to be capitalized.

Consistent with these examples, government officials have publicly stated that a regularly scheduled engine overhaul on a used aircraft should not be treated as a betterment merely because normal wear and tear on the engine between overhauls occurred prior to the purchase of the used aircraft. For example, if an engine overhaul is to be performed every 4 years on a noncommercial aircraft with a class life of 6 years, the overhaul could not meet the routine maintenance safe harbor. If the aircraft is purchased after two years of use and it has no material defects or conditions and only normal wear and tear on the engine, then the regularly scheduled engine overhaul in year 4 would not be a material betterment due to the nature of the work performed.

To clarify that such regularly scheduled maintenance would not be in the nature of a "betterment," please provide an example of this fact pattern.

**Note of typographical error:** Prop. and Temp. Treas. Reg. § 1.263(a)-3T(h)(4), *Example 3(ii)*, references paragraph (h)(2)(i) which should read (h)(3)(i).

#### **c. Post-Acquisition Repairs of Used Aircraft**

It is important to clarify this rule for used aircraft in the case of repairs that ameliorate both (i) a material condition or defect resulting from wear and tear that occurred before the taxpayer acquired the used aircraft and (ii) wear and tear that occurs after the taxpayer acquired the used aircraft. An example would be the acquisition of a used aircraft that has minor amounts of corrosion from pre-acquisition wear and tear, and on which repairs are performed a year later to correct more extensive amounts of corrosion that occurred after the acquisition. As discussed above, a repair can constitute a betterment if it ameliorates a material condition or defect that resulted from wear and tear occurring before the taxpayer acquired the used property. When a repair addresses material conditions or defects that existed at the time of the purchase of used property as well as subsequent wear and tear, the repair expense would need to be allocated between the pre-acquisition and post-acquisition wear and tear. We believe that this allocation would be fact-specific and therefore the only sensible method of allocation would be a facts and

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<sup>11</sup> Prop. and Temp. Treas. Reg. § 1.263(a)-3T(h)(1).

circumstances method. To minimize unnecessary controversy, taxpayers should be permitted to use any reasonable method to make this allocation.

Accordingly, we suggest the following sentences be added to Prop. and Temp. Treas. Reg. § 1.263(a)-3T(h)(3)(iii)(B):

In the case of an expenditure to repair a material condition or defect that resulted from the effects of wear and tear to a unit of used property prior to the taxpayer's acquisition of the unit of used property, only the portion of the repair expenditure attributable to the pre-acquisition wear and tear must be capitalized. The allocation of a repair expenditure between pre- and post-acquisition periods would be based on the facts and circumstances, and taxpayers may use any reasonable method to make such allocation.

### 3. RESTORATIONS

While we believe that the regulations do not require a **rebuilding** of a major component of a unit of property to be capitalized as a restoration or betterment,<sup>12</sup> we would like clarity on this matter in the form of a tangible personal property example showing the rebuilding of a **unit of property** as a restoration in contrast to the rebuilding of a **major component** of a unit of property as not a restoration or betterment. Specifically, we would like to see an aircraft engine overhaul example as a rebuilding of a major component, not resulting in a betterment or restoration consistent with the *FedEx* case.<sup>13</sup>

We further believe this type of example is needed to lessen the conflicts that will arise during audit on this issue due to the IRS *Capitalization v Repairs Audit Technique Guide* ("ATG").<sup>14</sup> The ATG arguably suggests that the court in *Ingram Industries*<sup>15</sup> would have held that "re-powering" of a tugboat engine (an overhaul) would have been subject to capitalization even though the issue was not before the court.<sup>16</sup> We believe that the engine re-powering, or overhaul, is not a "rebuilding" of a "unit of property"<sup>17</sup> and is not a "replacement" of a major component<sup>18</sup> as those terms are defined in the temporary and proposed regulations.

Please contact NBAA if we can provide any additional information. Thank you for your consideration of these comments.

Sincerely,



Mike Nichols  
Vice President, Operations, Education & Economics

<sup>12</sup> Prop. and Temp. Treas. Reg. § 1.263(a)-3T(i)(4).

<sup>13</sup> *FedEx Corp. v. United States*, 412 F.3d 617 (6th Cir. 2005).

<sup>14</sup> LB&I-4-0910-023 (November 2010).

<sup>15</sup> *Ingram Industries, Inc. v Comm'r*, TC Memo 2000-323.

<sup>16</sup> ATG app. B.

<sup>17</sup> Prop. and Temp. Treas. Reg. § 1.263(a)-3T(i)(1)(v).

<sup>18</sup> Prop. and Temp. Treas. Reg. § 1.263(a)-3T(i)(1)(vi).