May 1, 2013

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2013-22)
1111 Constitution Avenue, N.W.
Washington, D.C. 20224
VIA EMAIL: Notice.Comments@irscounsel.treas.gov

Re: Recommendations for 2013-2014 Guidance Priority List (Notice 2013-22)
Treatment of Leasing Activity Under I.R.C. § 280F(b)

Dear Sir and/or Madam:

This letter is submitted by the National Business Aviation Association ("NBAA") in response to the invitation published in Notice 2013-22 for recommendation of items for inclusion on the 2013-2014 Guidance Priority List. NBAA represents more than 9,000 member companies and is the leading organization for companies that own or operate general aviation aircraft to make their businesses more efficient, productive and successful.

For the reasons discussed below, we respectfully request that the Internal Revenue Service ("Service") review the treatment in TAM 200945037[1] of leasing aircraft to 5-percent owners and related parties under the depreciation limitation in I.R.C. § 280F(b) and provide administrative guidance as described below.

In addition to this letter, we are including an explanation of why Treasury and the IRS are not barred from implementing a "look-through" approach with regard the treatment of leasing activity under I.R.C. § 280F(b) (Enclosure 1), and a description of why businesses lease aircraft (Enclosure 2).

Background Regarding Depreciation Class Lives and Recovery Periods of Aircraft

Revenue Procedure 87-56[2] sets forth the class lives of property that are necessary to compute the depreciation allowances available under I.R.C. § 168. The revenue procedure specifies class lives and recovery periods for MACRS property subject to depreciation under the general depreciation system ("GDS") provided in I.R.C. § 168(a) or the alternative depreciation system ("ADS") provided in I.R.C. § 168(g).

An aircraft may fall into one of two asset classes within Rev. Proc. 87-56. Asset class 00.21 generally includes aircraft other than those used in commercial or contract carrying of passengers or freight. Aircraft placed into asset class 00.21 are assigned a GDS recovery period of 5 years, and an ADS recovery period of 6 years. Asset class 45.0 generally includes all other aircraft (i.e., those aircraft used in commercial or contract carrying of passengers or freight). Aircraft placed into asset class 45.0 are assigned a GDS recovery period of 7 years, and an ADS recovery period of 12 years.

The determination of the appropriate class life is based on the "primary" use of the aircraft.[3] The primary use may be determined in any reasonable manner.[4] In the case of leased aircraft, that determination is made based on the lessee's use of the aircraft.[5] If the primary use of the aircraft changes in a year after

[1] July 29, 2009.
[2] 1987-2 C.B. 674,
[3] Treas. Reg. § 1.167(a)-11(b)(4)(iii)(b).
[4] Treas. Reg. § 1.168(i)-4(d)(2).
[5] Treas. Reg. § 1.167(a)-11(e)(3)(iii).

the year in which it was initially placed in service, the depreciation deductions must be recalculated prospectively based on the new primary use.[6]

I.R.C. § 280F Requires the Alternative Depreciation System If Qualified Business Use of the Aircraft Does Not Exceed 50-Percent

I.R.C. § 280F(b)(1) provides that if any listed property is not predominantly used in a qualified business use for any taxable year, the deduction allowed under I.R.C. § 168 with respect to the property for such taxable year and any subsequent taxable year shall be determined under I.R.C. § 168(g) (i.e., the ADS rules). I.R.C. § 280F(b)(3) provides that property shall be treated as predominantly used in a qualified business use for any taxable year if the business use percentage for such taxable year exceeds 50 percent.

I.R.C. § 280F(d)(6)(A) defines the "business use percentage" to mean the percentage of the use of any listed property during any taxable year which is a qualified business use. Subparagraph (B) states that, except as provided in subparagraph (C), the term “qualified business use” means any use in a trade or business of the taxpayer. However, subparagraph (C) provides that qualified business use shall not include—

(i) leasing property to any 5-percent owner or related person;

(ii) use of property provided as compensation for the performance of services by a 5-percent owner or related person; or

(iii) the use of listed property is provided as compensation for the performance of services by any other person unless an amount is included in income (and withheld upon) with respect to that person.

If the listed property involved is an airplane, the above-mentioned business use by 5-percent owners and related persons is qualified business use if at least 25-percent of the total use of the aircraft during the taxable year consists of other types of qualified business use. The flush language of Treas. Reg. § 1.280F-6(d)(2)(ii)(A) provides that the exclusion of leasing listed property to any 5-percent owner or related person shall apply only to the extent that the use of the listed property is by an individual who is a 5-percent owner or a related party with respect to the owner or lessee of the property.

As explained in the legislative history to § 280F, the purpose of ACRS was to encourage investment in new equipment "rather than to subsidize the purchase of personal property that is used incidentally or occasionally in the taxpayer's business. Therefore, Congress decided not to allow the incentive portion of tax benefits for property whose predominant use is personal or investment-related, rather than in the conduct of a trade or business."[7]

As explained in TAM 200945037, “[t]he exceptions under section 280F(d)(6)(C) were designed to prevent a taxpayer from disguising excessive personal use by business owners and their employees by structuring the use as a lease or a compensation arrangement.”[8]

---

[6] Treas. Reg. § 1.168(i)-4(d).
[7] *See General Explanation of the Revenue Provisions of the Deficit reduction Act of 1984*, P.L. 98-369, Pages 559-560; *see also* TAM 200945037 (Nov. 6, 2009).
[8] TAM 200945037.

Issue: Whether Use of Property Leased to a 5-Percent Owner or Related Party Is Deemed 0-Percent Qualified Business Use

Under the above rules, the activity of leasing to a 5-percent owner or related party is not qualified business use. This raises the issue of whether (a) the flights conducted by the lessee should be deemed 0-percent qualified business use, or (b) the lessee's business flights should be treated as qualified business use.

Technical Advice Memorandum 200945037

TAM 200945037 specifically addresses this issue. The TAM explains that the taxpayer argued that in a lease of an aircraft to a 5-percent owner or related party, qualified business use should be determined based on the lessee's use of the property. The TAM notes that qualified business use does not exclude such leasing to the extent that the individual passengers are not 5-percent owners or related parties. However, without discussing the merits of the taxpayer's argument in the case of flights on which the passengers are 5-percent owners or related parties, the TAM concludes that such flights are deemed 0-percent qualified business use irrespective of the nature of lessee's actual use of the aircraft.

The Problem with the Holding in TAM 200945037

The problem with the holding in TAM 200945037 is that it is irrational to treat all flights on a leased aircraft as nonbusiness flights, and the holding in the TAM is not compelled by the language of the statute.

As noted above, while accelerated depreciation is intended to encourage the purchase of assets, § 280F(b) was adopted because the benefits of accelerated depreciation were not intended to be provided for listed property on which there is excessive personal use. For purposes of this test, qualified business use does not include the activity of leasing to a 5-percent owner or related party, because leasing merely disguises the real extent of the business and personal use by the lessee.

Interpreting § 280F(b)(6)(C) as treating all flights on an aircraft leased to a 5-percent owner or related party (when passengers are 5-percent owners or related parties) as personal flights for purposes of the predominant business use test in § 280F(b) fails to accomplish the purpose of making accelerated depreciation available to purchasers of assets when there is no excessive personal use of the asset. Taxpayers often place an aircraft in one entity and lease it to a related entity for legitimate non-tax business reasons (e.g., FAA compliance, limiting liability exposure, stakeholders' parameters, flexibility, and efficiency in management). By effectively overstating the extent of personal use in applying the predominant business use test, the TAM inappropriately denies the benefits of accelerated depreciation to purchasers of assets. In this regard, note that Congress' desire to encourage investment in business assets in the current economic environment is underscored by the extensions of bonus depreciation in recent years.

Furthermore, the specific reason for excluding leasing from qualified business use in § 280F(d)(6)(C) is that leasing would *disguise* the actual business use by the lessee. The rationale for this provision makes sense. If an owner of listed property leases it to a related party who uses the property for less than 50-percent qualified business use, then treating the leasing activity as 100-percent business would fail to accurately measure the percentage of business use. However, it does not follow that the business use percentage of such leased property should be deemed to be 0-percent. Since leasing disguises the real percentage of business use, the obvious solution is to lift the disguise as required by the statute and measure the qualified business use percentage based on the lessee's percentage of business use.

For example, based on the TAM, if two employees (who are not 5-percent owners or related parties of the employer) travel on an aircraft leased by the employer from a related party on the business of their employer, such use is qualified business use. However, if the same two employees traveling on the leased aircraft for the same business purpose happen to be 5-percent owners of the employer, such use would not be qualified business use for purposes of § 280F. Conversely, if the aircraft is owned by the employer (and not leased from a related party) the business use of the two employees (whether they are 5-percent owners or not) is qualified business use for purposes of § 280F. As can be seen by this example, it is arbitrary to distinguish what is qualified business use simply by who is on board (i.e., 5-percent owners or not) and whether the aircraft is leased from a related party or not. The business use of the leased aircraft is the same in any variations of the example described above and, thus should be treated the same for purposes of § 280F.

This conclusion that the qualified business use percentage of property leased to a 5-percent owner or related party should be determined based on the lessee's use of the property is consistent with the general rule discussed above that the depreciation life and method for leased property is determined based on the lessee's use of the property.[9]

The language of § 280F(d)(6)(C) does not compel the conclusion that all leasing to a 5-percent owner or related party (when the passengers are 5-percent owners or related parties) must be treated as 0-percent qualified business use. The statute is efficiently written to only exclude the activity of "leasing" from qualified business use. The statute does not go further in explaining how to measure qualified business use on the flights of a leased aircraft, but the statute should not have to do that. The appropriate test is already set forth in the statute for distinguishing business use from personal use.

Requested Guidance

Accordingly, we respectfully request that the Service provide guidance clarifying that business use of an aircraft by a lessee, who is a 5-percent owner or related party of the lessor of the aircraft, is qualified business use for purposes of I.R.C. § 280F.

We would appreciate the opportunity to discuss this issue with the IRS and Treasury. Please contact me at (202) 783-9451 or sobrien@nbaa.org if you have any questions or if you would like any additional information.

Thank you in advance for your consideration of this request.

Sincerely,

Scott O'Brien
Senior Manager, Finance & Tax Policy

Enclosures: 2

[9] Treas. Reg. § 1.167(a)-11(e)(3)(iii).

Enclosure 1

NBAA Explanation of Why Treasury and the IRS Are Not Barred From Implementing a "Look-Through" Approach With Regard to the Treatment of Leasing Activity under I.R.C. § 280F(b)

As detailed in the legislative history, one of the original purposes of enacting § 280F, as part of the Tax Reform Act of 1984, was to curtail the use of listed property (such as aircraft) by business owners for excessive personal purposes rather than for "qualified business use." The penalty for excessive personal use of aircraft, along with all other types of listed property, is the requirement that the aircraft owner use the longer recovery periods and slower depreciation methods of § 168(g), the alternative depreciation system ("ADS"), with regard to such property.

To such end, § 280F(d)(6)(C)(i)(I) provides that the term "qualified business use" shall not include leasing property to any 5-percent owner or related person. The statute does not explain how to measure qualified business use on the flights of a leased aircraft.

However, the flush language of Regulation § 1.280F-6(d)(2)(ii)(A) provides that § 280F(d)(6)(C)(i)(I) applies only to the extent that the use of the listed property is by an individual who is a related party or a 5-percent owner with respect to the owner or lessee of the property. The IRS noted in TAM 200945037 that the flush language in the regulations was a necessary clarification to the statutory language, for without such clarification all use of an aircraft under a lease to a 5-percent owner or related person would be excluded from "qualified business use."

During previous meetings and conference calls with Treasury and IRS National Office personnel, it has been indicated that the statutory language bars the Government from implementing such a "look-through" approach and that the only "fix" possible would be to change the statutory language to allow for a look-through rule. Yet, pursuant to § 7805(a), Treasury, and thus, the IRS, do possess the power to prescribe rules (through numerous formats, such as regulations, rulings, etc.) guiding taxpayers how to apply statutory rules. As a matter of fact, Treasury and the IRS have already done just that with regard to § 280F(d)(6)(C). As noted above, Treasury and the IRS have already clarified § 280F(d)(6)(C) once by issuing regulations as noted in TAM 200945037. The existence of the flush language in the regulations supports the proposition that the Treasury and the IRS have the ability to further interpret the statutory language of § 280F(d)(6)(C) to allow for a "look-through" approach in implementing the goals of Congress with regard to the enactment of § 280F.

Interpreting § 280F(b)(6)(C) as treating all flights on aircraft leased to a 5-percent owner or related party (when passengers are 5-percent owners or related parties) as personal flights for purposes of the qualified business use test is overbroad and in direct conflict with one of the original purposes of enacting § 280F. Such interpretation can result in a penalty when there is no personal use of the aircraft and thus fails to accomplish the purpose of curtailing excessive personal use. Such result also frustrates the purpose of Congress to make accelerated depreciation available to purchasers of assets when there is no excessive personal use of the asset. In order to more appropriately achieve Congress' purposes in enacting § 280F, the actual use of the asset by the lessee must be taken into consideration to determine the qualified business use. In other words, one must "look-through" to the actual use of the aircraft by the lessee to determine the true qualified business use percentage of the aircraft.

Accordingly, based on the legitimate non-tax business reasons described in the supporting materials submitted, we respectfully request that Treasury and the IRS provide guidance clarifying that the business use of an aircraft by a lessee, who is a 5-percent owner or related party of the lessor (or owner) of the aircraft, is qualified business use for purposes of § 280F.

Enclosure 2

NBAA Explanation of Why Businesses Lease Aircraft
RE: Treatment of Leasing Activity under I.R.C. § 280F(b)

Taxpayers often place an aircraft in one entity and lease it to one or more other entities for legitimate non-tax reasons.

FAA Compliance:

Leasing is a common method used by aircraft owners to comply with FAA rules. FAA operational rules make leasing necessary for certain types of aircraft uses. The general aviation rules in Part 91 of the FAA Regulations ("FAR") generally permits aircraft operations that involve no compensation or hire. Therefore, in order for an aircraft owner limited by the rules of FAR Part 91 to provide use of the aircraft, even to related parties, in compliance with the rules, leasing is necessary. Leasing an aircraft allows the lessee to operate the aircraft for the lessee's own use, generally also under the rules of FAR Part 91.

Aircraft owners may also lease to avoid the FAR Part 91 issue of the "flight department company." This term refers to a company that is set up solely for the purpose of owning and operating aircraft to provide air transportation. The FAA takes the position that a "flight department company" cannot operate an aircraft under FAR Part 91 because the carriage of persons would not be "incidental to" the business of that company. Nevertheless, a separate entity is permitted to own an aircraft and lease it to another company that operates the aircraft under FAR Part 91.

Leasing is also a common method to place an aircraft in commercial operations. An aircraft owner may lease an aircraft to a certificated air carrier in order that the aircraft may be used to provide transportation of passengers or property for compensation or hire. For business aircraft, such operations are generally conducted under FAR Part 135, which generally applies to air charter operations. In that case, the lessee must hold an air carrier certificate that authorizes the operator to conduct aircraft charter operations under FAR Part 135. In addition, the aircraft must meet the outfitting, equipment, and maintenance requirements of that Part.

The FAA also has complex citizenship rules for aircraft registration that may prevent a limited partnership or other entity from registering an aircraft with the FAA Aircraft Registry. In such instances, it is common practice for a separate company to register the aircraft with the FAA and lease it to such an entity for its business use.

Limiting Liability Exposure:

Generally under common law, each person who owns, operates, pilots, or maintains an aircraft is responsible for damages arising from that person's negligence or willful misconduct with respect to the aircraft. An aircraft owner may also be strictly liable for damages arising out of aircraft ownership under a products liability theory or a particular state statute. Leasing the aircraft allows aircraft ownership liability to be borne by the company that owns the aircraft and aircraft operational liability to be borne by the company responsible for the pilots and operating the aircraft for its particular flights.

Likewise, the owners of a business frequently place ownership of an aircraft in a separate entity that leases the aircraft to the business to protect the aircraft from liability exposure arising from other operations of the business.

Stakeholder's Parameters:

The owners of a company may have differing purposes or concerns with regard to an aircraft used for company business travel. In such instances, it is common for the aircraft to be owned in a separate company with an overlapping but not identical ownership to the main business. This structure enables

the owners who have direct business use of the aircraft to proportionately bear the capital and other costs of aircraft ownership.

In some instances, aircraft owners must structure ownership of the aircraft to meet the requirements of their lenders. A commercial lender for a business may limit the types of assets that a particular company may own, including requiring that an aircraft be owned in a separate company. This separate ownership may be required to strengthen the lender's security rights in and to the aircraft and to facilitate any potential future repossession by the lender. Where multiple lenders are involved in a business, separation of asset ownership may also be required. In these circumstances, leasing allows a company to use the aircraft for its own business purposes while complying with the lender's financing requirements.

Similarly, in certain highly regulated industries (e.g., public utilities, banks, insurance companies), industry regulations may discourage direct ownership of an aircraft. In such cases, it may be necessary to place ownership of an aircraft in a separate entity that leases the aircraft to comply with the regulations.

State Tax Flexibility:

Many aircraft owners use a leasing structure for state sales tax reasons. A leasing structure can allow state sales tax to be paid by its user(s) on lease payments instead of by its owner immediately upon its purchase.