Public Hearing on Proposed Regulations [REG-104397-18]
Testimony by John B. Hoover on Behalf of the National Business Aviation Association
Regarding the Definition of "Binding Written Contract"
Under Prop. Treas. Reg. § 1.168(k)-2(b)(5)(iii)
November 28, 2018

I am John Hoover. I am vice chair of the NBAA Tax Committee, and I appreciate the opportunity to speak to you on behalf of the National Business Aviation Association with respect to the proposed regulations regarding bonus depreciation under I.R.C. § 168(k). The NBAA represents more than 11,000 member companies and is the leading organization for companies that own and operate general aviation aircraft.

The NBAA requests that the definition of "binding written contract" in Prop. Treas. Reg. § 1.168(k)-1(b)(5)(iii) be modified to make it clear that a binding written contract is a contract that is binding on the taxpayer (that is, the buyer), rather than on the seller.

This clarification is important because the bonus depreciation rate will begin phasing down in 2023. The phase-down dates are generally extended by one year for taxpayers who have entered into a binding written contract to buy an aircraft prior to the otherwise applicable phase-down date.

The proposed regulation, and the existing bonus depreciation regulation at Treas. Reg. § 1.168(k)-1(b)(4)(ii), define a binding written contract as follows:

> 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).

The proposed regulation then explains that a liquidated damages provision limiting damages to an amount that is at least 5% of the contract price will not be treated as limiting damages to a specified amount. In other words, a contract will not be considered binding if it provides for liquidated damages below the 5% threshold against the buyer in the case of the buyer's breach.

The first part of this definition makes it clear that a binding written contract only needs to be binding on the taxpayer (that is, the buyer). However, the second part states that the contract must not limit damages to a specified amount, without specifying who the limitation on damages relates to.

This omission has resulted in confusion as to whether a liquidated damages provision applicable to the seller in the case of the seller's breach will cause the contract to fail to be a binding written contract.

To resolve this ambiguity, we request that the definition of binding written contract be modified to add the words "in the case of breach by the taxpayer or a predecessor" so that the definition would state:

> 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 in the case of breach by the taxpayer or a predecessor (for example, by use of a liquidated damages provision).

We believe this clarification is appropriate for the following reasons:

First, the definition provides the general rule that the contract must be binding against the buyer. The statement that a contract will not be considered as binding if it provides for liquidated damages of less than 5% of the contract price logically relates only to *what* constitutes a binding contract, not *who* it must be binding against.

It would not make sense for the definition to be interpreted to mean that a contract that is generally not binding on the seller could qualify as a binding written contract, but a contract that contains a liquidated damages provision limiting damages against the seller would fail to be a binding written contract.

Second, it makes sense for the binding written contract requirement to relate to the buyer, because it is the intent of the taxpayer (that is, the buyer) in entering into the contract that should be relevant to the taxpayer's eligibility for bonus depreciation.

Third, in PLR 88-200-80, the IRS has interpreted this liquidated damages limitation in the binding written contract definition to apply only to the buyer. In this published ruling, the IRS explained:

> The above cited language from the Conference Report that addresses limiting damages to a specified amount pertains to those damages for which the party claiming the benefit of the binding contract rule . . . would be liable.

Fourth, in a typical aircraft purchase contract, a 5% liquidated damages provision may be reasonable with respect to a buyer. However, liquidated damages provisions applicable to sellers typically only require the seller to reimburse the buyer's out-of-pocket costs and pay interest to the buyer on the return of the buyer's deposit.

Accordingly, a 5% liquidated damages amount imposed on the seller would substantially exceed the amount generally regarded as necessary to make the buyer whole. For that reason, such a high liquidated damages amount with respect to the seller may be unenforceable as a penalty under applicable state contract law. This would make it impossible for a contract to be a binding written contract, if the definition of binding written contract were interpreted to require a 5% liquidated damages amount against the seller.

For these reasons, we request that the definition of "binding written contract" be clarified to only require the minimum threshold for liquidated damages against the taxpayer.