Tax Consequences of a 2018 Year-End Aircraft Purchase

Derek A. Bloom
Scott C. Burgess
John Hoover[1]

Disclaimer: This NBAA article is intended to provide members with an introduction to the rules that relate to bonus depreciation. This article is not intended to provide more than an illustrative introduction to the subject matter, and since the information is general in nature, it is no substitute for the advice of legal and tax advisors addressing a specific set of facts that readers may face.

There has been much publicity that the Tax Cuts and Jobs Act of 2017 allows 100 percent of the cost of a new or used aircraft to be immediately expensed as a depreciation deduction. However, if a taxpayer claims this depreciation deduction after purchasing an aircraft and placing it into service during the last quarter of 2018 (or the last quarter of a subsequent year through 2022), the taxpayer may find that the rate at which it will be allowed to depreciate other property acquired during the year will be substantially slowed with retroactive effect to the beginning of the relevant year. This may offset part of the benefit of the immediate expensing of the cost of the aircraft.

The "mid-quarter convention," which is intended to prevent taxpayers from claiming disproportionately large depreciation deductions in a tax year based on the purchase of depreciable assets during the last quarter of a calendar year, applies if the total depreciable basis of all property placed in service by a taxpayer during the last three months of a tax year (such as an aircraft, but excluding certain real property and other non-qualifying assets) is more than 40 percent of the total depreciable basis of all property placed into service in the tax year.

If the mid-quarter convention applies due to an aircraft purchase in 2018, the cost of the aircraft may indeed be 100 percent expensed on the 2018 tax return. However, the potential depreciation deduction attributable to all other assets acquired during 2018 and otherwise depreciable pursuant to modified accelerated cost recovery system (MACRS) or Alternative Depreciation System (ADS) may be slowed. The other assets will be considered to have been placed in service at the midpoint of the relevant quarter. The reduction in the depreciation deductions with respect to these other assets will be deductible in future years according to schedules set out at the back of Internal Revenue Service Publication 946.

Section 167(a) of the Internal Revenue Code (the "Code"), as amended by the Tax Cuts and Jobs Act, sets out the general rule that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) (1) of property used in the trade or business, or (2) of property held for production of income. Section 168(a) of the Code adds that the depreciation deduction provided by section 167(a) for any tangible property, such as an aircraft, shall be determined by using (1) the applicable depreciation method, (2) the applicable recovery period, and (3) the applicable convention.

1 Derek Bloom and Scott Burgess are attorneys with Aviation Legal Group, P.A and can be reached at (954) 763-5565. John Hoover is Vice Chair of NBAA's Tax Committee and a partner with Holland & Knight, he can be reached at (202) 469-5468

An aircraft may qualify for bonus depreciation under Section 168(k)(1)(A) of the Code, which provides that "[i]n the case of any qualified property (A) the depreciation deduction provided by section 167(a) for the taxable year in which such property is placed in service shall include an allowance equal to the applicable percentage of the adjusted basis of the qualified property. "Qualified property" is defined in Section 168(k)(2)(A) of the Code to mean property, such as an aircraft, which has a recovery period of 20 years or less, and the original use of which begins with the taxpayer [i.e., a new aircraft] or the acquisition of which by the taxpayer meets the requirements of clause (ii) of subparagraph (E) [i.e., a used aircraft].

Section 168(k)(6) of the Code provides that, except as otherwise provided in this paragraph, the term "applicable percentage" means 100 percent in the case of property placed in service after Sept. 27, 2017, and before Jan. 1, 2023. (After 2022, a phase down of applicable percentage becomes effective). Accordingly, 100 percent of the cost of an aircraft acquired and placed into service in 2018 may be expensed as a depreciation deduction for 2018.

Section 168(d)(3) sets out a special rule for the applicable convention if (i) the aggregate basis of property placed in service during the last three months of the taxable year, exceeds (ii) 40 percent of the aggregate bases of property to which this section applies placed in service during such taxable year. If so, the applicable convention for all property to which this section applies placed in service during such taxable year shall be the mid-quarter convention.

Internal Revenue Service Publication 946 includes a series of tables which show by what percentages the planned depreciation of all other assets purchased in the four quarters of 2018 would be affected if the purchase of an aircraft in the last quarter of 2018 has the effect of causing all other assets purchased during 2018 to be depreciated pursuant to the mid-quarter convention. The rate of depreciation is slowed dramatically for other assets purchased in the third or fourth quarter of 2018. For example, Table A-5 shows that, in the case of five-year and seven-year property, only 5 percent and 3.57 percent of depreciable basis, respectively, would be deductible in 2018.

In sum, if the timing of an aircraft purchase and placement into service triggers the application of the mid-quarter convention to a taxpayer's purchase of all depreciable assets it acquired during 2018, the cost of the aircraft may nonetheless be 100 percent expensed (subject to pro-rata reductions for non-business use). However, otherwise expected depreciation deductions for all other assets acquired in 2018 may be slowed and the present value of the other expected depreciation deductions would be reduced. Accordingly, a taxpayer planning a year-end aircraft purchase will want to analyze the consequences for all other planned depreciation deductions during the tax year.