



Joint Ownership of Aircraft – A Tax Perspective

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The use of an aircraft in a trade or business will generally provide deductible expense provided the expenses are ordinary, necessary, and reasonable in amount. However, the enjoyment of these tax deductions may be postponed or even permanently eliminated based on the structuring of aircraft ownership or operational entities.

Aircraft titling is regulated by the federal government through the Federal Aviation Administration. The FAA allows an aircraft to be titled by both individuals and co-owners, and include corporations, partnerships, limited liability companies, and trusts. Entities that register aircraft generally have restrictions on both managers and holders of beneficial interest.

The mere titling of an aircraft in a business name does not give rise to business deductions. Obviously, merely putting an aircraft in a business name and using it solely for personal use will not convert the personal use to business use. The Internal Revenue Service has promulgated regulations to assist taxpayers in understanding how the government will perceive their activity; as a trade business or as a non-deductible “hobby”. These restrictions provide nine relevant factors to assist in evaluating the profit intent of each set of facts and circumstances. These tests include items such as the manner in which the activity is conducted, the expertise of the taxpayer and his advisors, the taxpayer’s time and effort, the taxpayer’s history in this and other businesses, the expectation of appreciation in assets, and the personal pleasure derived from the activity.

A second area of concern for owners and operators of aircraft often relates to the passive activity limitations. These limitations prevent a taxpayer from deducting otherwise allowable business losses resulting from an activity that is either a leasing activity, or another business activity in which the taxpayer does not materially participate. There are often many non-income tax reasons to acquire an aircraft in a subsidiary assisting business enterprise rather in the enterprise itself. These reasons include such items diverse as financial statement presentation, liability protection, and state and local tax considerations. Nonetheless, it is important that the income tax considerations are considered in the design of ownership of the aircraft in a separate entity. In the absence of proper planning the acquisition of an aircraft in a separate entity may result in the inadvertent classification of its deductions as subject to the passive activity rules.

The Internal Revenue Code Regulations recognize that there may be certain circumstances in which multiple undertakings could be aggregated for the purpose of determining what constitutes an activity.

The Regulations recognize an economic reality wherein it is appropriate for the taxpayer to own two entities that support one another. For example, a subsidiary may hold an aircraft that is rented to other members of the controlled group. The purpose is to support the group, and not by necessity be expected to earn an economic profit on a stand-alone basis. In fact, the Federal Aviation Regulations often prohibit allocation of cost beyond actual costs even among members of a controlled group. Likewise, the IRC Regulations also provide that an appropriate economic unit exists in a properly structured taxpayer's group in what might otherwise constitute a passive activity if participation is measured on a stand-alone basis. By combining a potential passive activity with an active trade or business, it may be possible to convert them both into a single active activity. In determining what is an appropriate economic unit, one of the factors to consider is ownership of the two undertakings that the taxpayer elects to combine.

Earlier in this article we alluded right to title and register aircraft not only as sole owners, but also as co-owners. If a limited liability company was created for multiple members to own an aircraft, it would normally be taxed as a partnership for federal income tax purposes. The business purpose and the allocation of items to income and expense, as well as capital, would normally be determined at this entity level. If on the other hand, these same members elected to co-own an aircraft in their individual limited liability companies rather than serve as owners of a beneficial interest of a single limited liability company, a partnership would generally not be created for federal income tax purposes. Provided that these co-owners did not conduct business together, their activity would generally be reportable in their own tax returns rather than flowing through a partnership return. This would normally result in the tax consequences of each ownership interest being determined solely on the basis of their relative interest, as opposed to the activities of each of the partners.

When individual companies co-own an aircraft outside of the partnership arena, the cost of ownership and operation of their respective interests is borne separate from that of those of their partners. They are more likely to be subject to grouping under both the passive activity rules and the trade or business rules as an appropriate economic unit. Ownership of a partnership interest opposed to an undivided interest in property further removes the economic interrelationship of the parties.

Regardless of the means of owning and operating an aircraft, the first hurdle to achieving deductibility of expenses must be its operation in a trade or business. To the extent that the aircraft is jointly owned, it is also important that the non-tax considerations of joint ownership do not destroy what otherwise constitutes deductible expenses due to the manner in which the aircraft is owned and operated. An effective plan is one that considers both the tax and non-tax elements of co-ownership.

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