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# Private aircraft

## Flying private makes sense for those with the right information

"Deloitte assisted our company in structuring and audit dispute resolution for the ownership and use of an aircraft. The advice and services we received were consistent with the high quality that we've become accustomed to."

— Tax Director, Family Office

# Contents


The private flyer profile 2

Aircraft ownership options: Setting your flight plan 3

Tax impacts: What you need to know 5

Taking flight 17

Appendix: Looking deeper into the ownership types 18


It's easy to understand why people fly by private aircraft. Private air travel offers unmatched comfort, privacy, and convenience with the benefits of no security screenings, no crowded commercial flights, no lost luggage, and fewer flight delays. If you've made the choice to fly private, then addressing the related financial and regulatory compliance requirements is your next step. And remember — it's important to always work with tax and legal counsel to make final decisions that match your specific goals and needs.

In this article, we will address the important decisions you will need to make.
**We'll also answer questions like:**

- Do I fly often enough to warrant purchasing a plane or should I consider other alternatives?
- What cost structure best fits my usage pattern?
- How is personal travel handled?
- Are there tax implications?

# The private flyer profile

## Reasons why flying private can make sense

**Do you or your family:**

- Travel often on short notice?
- Need to travel to areas that lack adequate commercial airline service?
- Have business interests located far from a major airport?
- Have vacation homes in out-of-the-way places?
- Have security or privacy concerns?
- Want more business or family time on trips?
- Need to work uninterrupted during the flight time?

**If you answer yes** to one or more of these concerns, you may be a candidate for a private aircraft.

Every private flyer is looking for the most efficient way to fly at the best possible price. Whether you are a wealthy individual, a closely-held business owner, an entrepreneur or any other type of aircraft user, the issues involved in flying private are complex. If you are ready to move forward, the discussion needs to take into account numerous factors.

# Aircraft ownership options: Setting your flight plan

## TIP How often you'll use a private aircraft is an important consideration

In situations where it is difficult to predict usage, it usually makes sense to start out by chartering an aircraft or purchasing a flight card until you have a better understanding of how often, how far, and how many people will be flying. Especially if passenger loads will tend to vary widely from trip to trip, the flexibility of charter and flight cards may be advantageous, as they allow you to size the aircraft to meet each flight's requirements.

You may not need to actually buy a plane to fly private. The truth is that the costs and responsibilities of such a large purchase may not match the investment. For the majority of those who need private aircraft, there are attractive partial ownership options. The chart on the next page shows a summary of various aircraft ownership options, and the appendix on p. 18 gives a more detailed view of these options.

Aircraft management companies may have different options within the various ownership types noted below.

## Matching your needs to the right aircraft option

The option you choose depends on your specific needs.

| Option | Description | How many passengers per trip | Advantages | Disadvantages |
|---|---|---|---|---|
| **Full ownership** | You or your entity owns the plane | Your choice, within your aircraft's seating capacity limits | Full control over every aspect of the plane: crew, maintenance, inspections, hours flown, and passengers<br>Depreciation benefits | Full liability<br>Equipment wear and tear, which affects residual value<br>Variable operating costs<br>Bears direct cost of repositioning the plane |
| **Fractional ownership** | You or your entity typically owns 1/16 to 1/2 of an aircraft through a third party (a fractional share provider) | Can be scaled to the specific trip needs | Lower up-front capital outlay<br>Guaranteed plane availability<br>Depreciation benefits<br>Choice of plane size<br>Planes are professionally managed and maintained<br>No charges (generally) for deadheading or repositioning costs<br>Possibility of guaranteed plane buyback | Can be relatively expensive to use per hour<br>Planes are used more heavily<br>There are limits on peak flying dates<br>Liability could be high, depending on whether the owner or operator is in operational control |
| **Joint ownership** | You sign an FAA-sanctioned agreement to share the cost of operating an aircraft | Limited to the size of the plane purchased specifically by the joint owners | More cost effective per hour than fractional ownership<br>Depreciation benefits | Less flexible<br>Finding a responsible partner<br>Aircraft availability |
| **Chartering** | You contract for services on a trip-by-trip basis or use the services of a charter broker | Can be scaled to the specific trip needs | Flexible<br>Cost effective<br>Less liability<br>Ideal when flight usage is sporadic or difficult to predict | Inconsistency in service experience and costs<br>Less convenient or less consistent as other choices<br>Additional advanced notice needed to schedule flights<br>Competition for peak usage periods<br>Fuel surcharges, pilot wait charges, landing fees and deadhead hour charges |
| **Flight cards** | You purchase either a block of flight hours or a specific dollar balance | Can be scaled to the specific trip needs | Price competitive with charters<br>Allows family members to fly to multiple destinations at the same time using different aircraft | No benefits of depreciation<br>More expensive per flight hour than fractional ownership hours |

**For a more detailed discussion on the ins and outs of private aircraft ownership options refer to the Appendix on page 18.**

# Tax impacts:
# What you need to know

## TO DO...

Identify and evaluate a tax advantageous legal entity to hold the aircraft ownership interest.

Understanding the tax implications of flying private can help you choose the ownership structure that appropriately addresses your specific needs and circumstances.

**Structuring ownership for tax purposes**
The immediate instinct of most aircraft buyers is to put the plane in a separate legal entity instead of placing it directly in an operating business in order to protect the owners from legal liability. Unfortunately, this can create significant tax problems. Payments between related entities can attract federal excise taxes, which are imposed on "air transportation." It also may create a captive charter company, which may subject it to certain FAA rules applicable to operators that "carry passengers for hire." Generally, providing air transportation and carrying passengers for hire occurs when there is a single payment to one entity for both the provision of the aircraft itself as well as the provision of pilots. High net worth individuals and families should always consult competent legal counsel and tax professionals when structuring the ownership of an aircraft.

## TO DO...

Before purchasing an aircraft, make sure you understand any sales or use tax liabilities due at the time of the acquisition and during the period in which the aircraft is used.

**Sales and use taxes on aircraft purchases**
Many states provide exemptions from sales and use tax for the purchase of an aircraft, such as an exemption for aircraft used in interstate commerce and an exemption for leased aircraft (although the future lease payments may be subject to sales/use tax). It is important, however, to understand if one of these exceptions is met (and continues to be met for the period of the aircraft's use). The determining factor in concluding which state's taxability rules to apply is the principal hanger location for the aircraft and/or where the aircraft will be located.

## TO DO...

Preserve documentation to support the expense is an ordinary and necessary business expense.

## TIP Deductibility of business passengers

Costs related to business passengers are fully deductible without limitation. An example of business passengers would be if corporate executives went to visit a customer or vendor.

**Deductible business expenses**
One of the most important questions that must be addressed is when the cost of private aviation is considered an ordinary and necessary business expense. If business is typically conducted locally, or business travel is between major cities that are regularly served by the major airlines, it may be difficult to justify the cost of private air travel as an ordinary and necessary expense of the business. A better argument exists when the business requires flights to out-of-the-way locations without ready commercial air service, the timing and duration of business flights are unpredictable, or personal security is a significant concern.

Once the ordinary and necessary requirement is met, the next issue is to determine which costs are deductible and which are not. If the aircraft is owned by an entity (other than a Single Member LLC owned by an individual), costs need to be apportioned to each passenger on each flight and then allocated between business and personal (which includes personal non-entertainment and personal entertainment). If the aircraft is owned by an individual or through a Single Member LLC, there is a different allocation methodology to determine any expenses that may not be deductible.

**Determining disallowed expenses**
For purposes of determining the expenses allocated to entertainment air travel of a specified individual, a taxpayer must use either the occupied seat hours or miles, or the flight-by-flight method. A taxpayer must use the chosen method for all flights of all aircraft for the taxable year.

## TIP Flying for both business and personal purposes

When flying for more than business use, it may make sense to access different aircraft for each purpose in order to preserve the deductibility of the business flights and not dilute deductibility by using a business aircraft for personal entertainment purposes, the cost of which is not deductible.

**Personal travel using private aircraft**
Many people start out believing they will use a private aircraft strictly for business. Once they try it for personal travel, however, they often increase personal usage steadily. This change creates tax effects that are important to understand.

The American Jobs Creation Act of 2004 and its related subsequent regulations have put limitations on the deductibility of aircraft use. Generally speaking, aircraft use is deductible for business purposes, but it may not be deductible when flown for personal use, depending on the category of the flight. Personal aircraft usage breaks down into two categories — personal non-entertainment and personal entertainment.

Further, personal travel is also considered a fringe benefit provided to the employee or owner in which income needs to be imputed to the individual, or reimbursed, for use of the aircraft. Most companies, when imputing income to an executive for personal use of an aircraft, utilize the Standard Industry Fare Level (SIFL) tables. SIFL tables can require an amount of income to be imputed to the individual that is less than the actual cost of operating the aircraft.

## TIP Types of personal non-entertainment flights

Personal non-entertainment flights can include commuting, traveling for a funeral, traveling to visit a sick relative, traveling to receive medical treatment, or traveling to see an advisor.

**Personal non-entertainment usage**
As long as the executive has compensation imputed to him or her for the flight, or reimburses the company an appropriate amount, personal non-entertainment flights are fully deductible by the company. For example, commuting is considered personal non-entertainment, but is not specifically defined in current guidance. Generally speaking, travel constitutes commuting any time you are traveling from a personal residence (defined as a residence used personally more than 10 percent of the time or for more than 14 days per annum) to your principal place of business. Accordingly, a regular pattern of travel between your place of employment and a personal residence can constitute commuting, making it a personal non-entertainment flight, allowing the company to deduct the entire cost as long as there is proper imputation of income to the individual.

## TO DO...

Impute compensation for personal travel to the employee, or collect reimbursement from the employee for aircraft expenses (while being mindful of excise tax and FAA consequences associated with reimbursements).

## TIP Vacation flights

Personal entertainment flight examples could include flying to vacation locations, flying to visit friends or relatives, or flying to any other place that has a significant "fun factor" to it.

**Personal entertainment**
If a specified individual (generally defined as an owner, shareholder or officer of a company) flies for personal entertainment purposes, the cost of the flight is only deductible to the extent compensation has been imputed to the individual for the flight or the specified individual reimbursed the company for the cost of the flight. Personal entertainment is broadly defined and generally includes all personal travel that is not otherwise categorized as personal non-entertainment.

## TO DO...

Look at each individual passenger's purpose as the primary tax treatment driver.

**Spouses traveling on business trips**
A frequently asked question is whether a spouse's travel is deductible when he or she is flying with an executive who is traveling for business reasons. The statute specifically provides that such spousal travel is not deductible unless the spouse is an employee of the company and is also traveling for business purposes. However, if the spouse's travel can be considered personal non-entertainment travel (i.e. they are traveling as a companion to a business event where spouses are expected/encouraged to attend), income related to the spouse's travel would be imputed to the executive, which could then make the full cost of the travel deductible.

## TO DO...

Generally, straight-line depreciation for aircraft depreciation may be appropriate if there is likely to be significant personal use.

**Depreciation**
Aircraft depreciation and the related calculations are complex. First, a determination to compute depreciation methodology needs to be made. If accelerated depreciation methods are used, each year the business use will need to be analyzed to determine qualification for the accelerated method. If there is a likelihood of significant personal use, it is advisable to use straight-line depreciation rather than accelerated depreciation (e.g., the Modified Accelerated Cost Recovery System, also known as "MACRS") because significant amounts of accelerated depreciation are likely to be recaptured immediately, if qualified business use falls below a specified threshold. Further, tax depreciation expense is required to be included in the allocation of other aircraft expenses between deductible and nondeductible usage. This allocation each year will also factor into the gain or loss upon the sale or exchange of the aircraft.

## TO DO...

Consider the need for cost reimbursements which may result in paying additional excise taxes than otherwise required.

**Excise Taxes**
Federal excise taxes are imposed on both payments for transportation by air and the purchase of aircraft fuel (fuel tax). Excise tax on flights of private aircraft is typically collected at the pump at a higher rate in cases where the aircraft is not for hire. However, reimbursements from related parties for air transportation frequently can result in unintended imposition of the ticket tax, since such payments may be viewed as compensation for transportation by air. For chartered aircraft, as with the commercial airlines, the ticket excise tax is equal to 7.5 percent of the cost of the ticket or the amount reimbursed. As a general rule, either the higher fuel tax or the ticket tax should apply, but not both. There is also a separate fuel excise tax for fractional aircraft interests.

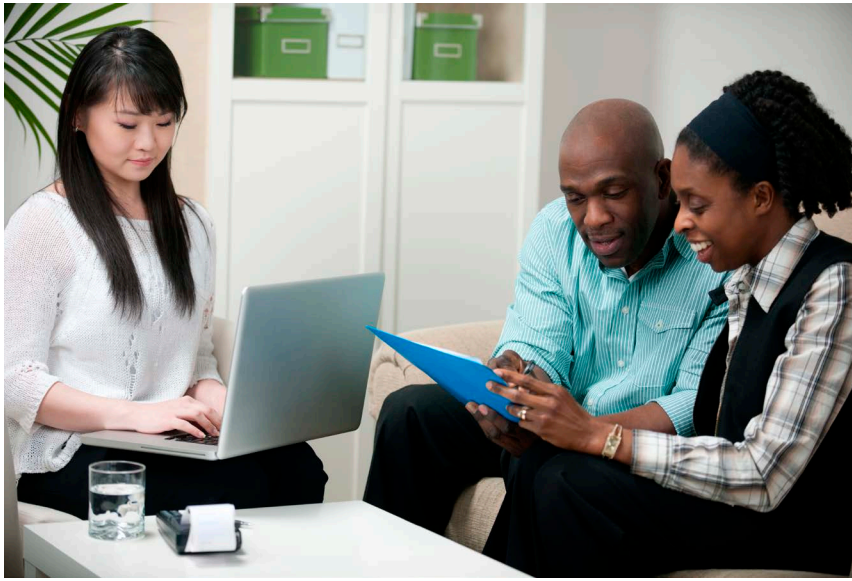
"Excise taxes are imposed on payments for transportation by air, so careful structuring of these payments is critical because additional excise tax liabilities can arise when related parties reimburse for the use of the aircraft."

— Bina Patel, Director, Deloitte Tax

## TO DO...

Fully determine personal use before finalizing the gain/loss calculations on an aircraft disposition.

**Selling your aircraft**
Gain or loss on a disposition of an aircraft can be difficult to calculate, as there are differing methodologies for calculating basis on a disposition. The applicable methodology for calculating basis not only impacts taxable dispositions of aircraft, but also impacts the results of like-kind exchanges. It is important that taxpayers understand the various authorities regarding how basis of an aircraft is impacted by personal use before finalizing the gain/loss calculations on a disposition of an aircraft.



## TO DO...

Consult a specialist on international law and taxation before taking your aircraft out of the country.

**Overseas travel**
Operationally, a plane being flown within the airspace of a particular country is subject to that country's regulations. Also, different countries may control portions of international airspace, such as the space over oceans. You should understand the rules applicable to your travel route, stops, and destinations. With regard to taxation, there are complex rules regarding international travel, especially in the context of travel expenditures incurred by individuals.

## TO DO...

Perform a in-depth disallowance calculation before completing any tax return.

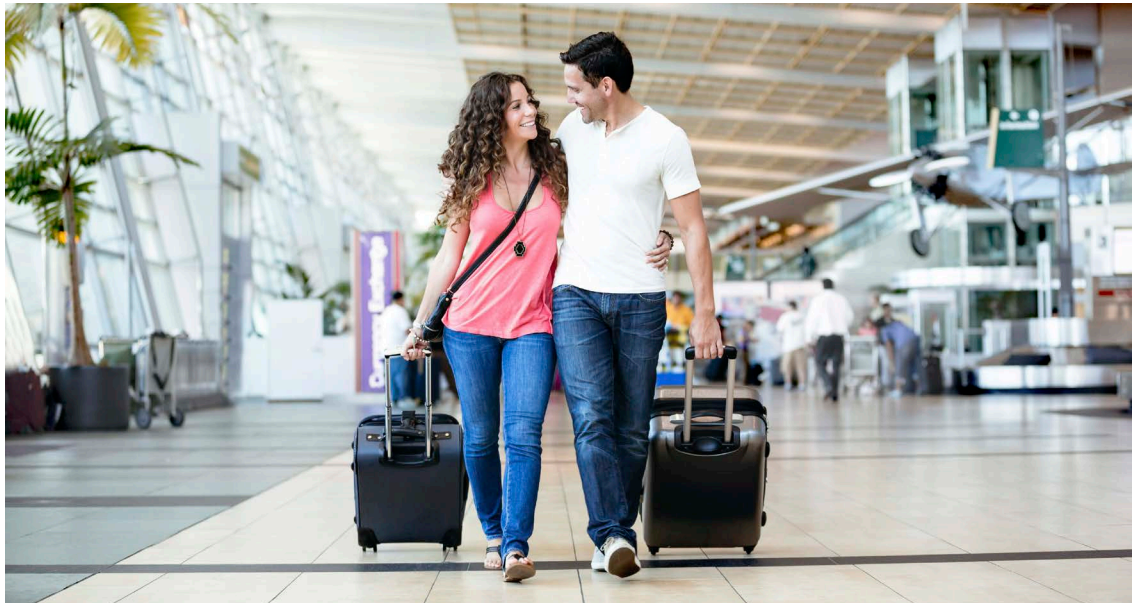
**Defending an examination**

The IRS and other taxing authorities scrutinize aircraft deductions frequently. We have worked with many high net worth individuals and families on examination defense, and we have found that some of the common issues that must be addressed include:

- Not calculating the amount of deduction that is disallowed
- Errors in the disallowance calculation
- Poor documentation to substantiate business use and personal non-entertainment use for individual passengers
- Incomplete or unaccounted excise tax liabilities

The FAA requires a flight log that includes such data as destinations, flight hours, miles flown, and a list of passengers. Aircraft owners or users typically convert this information to a spreadsheet periodically and add other information like a breakdown of business and personal passenger use, but may not have a system in place to provide accurate or complete information upon examination. Examination defense can be time-consuming and costly, and we find that our clients benefit from specialized, professional tax advice while preparing the returns before the initial filing. When we help our clients during an examination, we resolve controversies by mitigating the tax risk and the penalty risk to our clients.

# Taking flight



There are many ways to access private aircraft. As we've described in this article, you may consider owning, chartering, or purchasing a flight card. Before finalizing your purchase, you will benefit from consulting with aircraft specialists, including tax specialists, buyer brokers, and attorneys who understand the complexities of private aviation.

Private aircraft can be a valuable travel option offering superior convenience, comfort, and control for high net worth individuals and families. It starts by considering the economic, tax and legal issues. We hope the information provided here will help you start thinking about the decisions you'll need to make as you prepare to take flight.

" I have found the Deloitte advice very technical associated with our specific facts — having a diverse fleet of corporate aircraft dealing with everything from entertainment issues, loss disallowance calculations, preparation of models and utilization of flight logs and records to support our tax positions. Particularly useful is the ability to be practical in the application of IRS code and regulations to everyday operations. Not many service providers provide both technical and practical solutions in this arena. They are fantastic!"

— Tax Director, Family Office

# Appendix: Looking deeper into the ownership types

**Following is more detail about the ins and outs of each ownership method.**

### Full ownership

With full ownership, you have complete control over the plane and crew. You know where the plane has flown, who has been on it, how many hours it has logged, and when it was last inspected and maintained. You have control over whom you hire to fly the plane and what their experience level is in that particular type of aircraft. You can equip the plane any way you wish, and you can be certain that the aircraft is maintained up to your personal standards.

Owning an aircraft can be complicated, time-consuming, and expensive. It is important to understand the pretax and post-tax cost implications. Besides the sizable initial investment, owners need to hire pilots and crew, provide for ongoing maintenance, manage scheduling, and pay for deadheading (or repositioning) of the aircraft (making sure it is always where you need it at any given point in time). These functions can be outsourced to a third-party flight management company, but whether they are handled in-house or outsourced to a third-party provider the costs are significant. Full ownership can also decrease flexibility for owners if they need different size aircraft at different times.

With ownership of an aircraft comes greater liability compared to other forms of private flying. Under normal circumstances, you as the owner are generally deemed to be in operational control of the aircraft, which carries with it greater responsibility and potential liability. This can be contrasted with a charter flight, where the charter operator is deemed to be in operational control. An owner also has the economic risk of depreciation on the aircraft, resulting in a higher or lower residual value at the end of the period of use. This residual value depends on such factors as general economic conditions, the make and model of the aircraft, and the supply of used aircraft on the market at the time of sale. Variable operating costs can be defrayed by making the plane available for charter to third parties; however, doing so typically reduces flexibility, not to mention the wear and tear on the aircraft and its engines. Finally, full ownership may be the most expensive option, but depending on your usage, it can be the cheapest option in cost-per-mile terms if you use it heavily. It is important to examine each variable to make a final choice that is a good fit for your specific needs.

### Fractional ownership

Purchasing one-sixteenth to one-half ownership of a plane provides adequate availability for many people. Fractional ownership requires a proportionately lower up-front capital outlay than full purchase. The availability of your plane (or a comparable one) is guaranteed, and you can choose to fly in a larger or smaller size aircraft to accommodate your specific travel needs. Fractional programs most likely will have a limit on the number of hours you can fly during peak holiday periods.

Fractional aircraft are professionally managed and maintained. With fractional ownership, you generally are not directly charged for deadheading or repositioning costs, which are instead factored into the monthly and hourly charges you incur. Many fractional operators guarantee a buyback of the plane at fair market value (less a significant remarketing fee). Fair market value is dependent on resale prices at the time, so the fractional owners bear the risk of the residual value at the end of the program, which is usually five years. Planes coming off of fractional programs almost always have more hours than an average aircraft of the same age and, therefore, generally have a lower-than-average residual value.

On a cost-per-hour basis, fractional ownership is generally considered to be a fairly expensive way to access private aircraft. You also will need to provide more advanced notice of travel requirements than with full ownership. Fractional programs cover fixed costs by charging a monthly fee, which is set by the management company without owner input — although there are usually limits in the contract as to how much and how often the fee can increase over the term of the contract.

From a liability perspective, it is difficult to compare fractional ownership with full ownership of an aircraft. Some fractional providers operate their aircraft under the charter rules, such that the fractional operator is in operational control. Others operate under special rules for fractional interests in which the owner has operational control of the aircraft.

### Joint ownership arrangements

A joint ownership arrangement is an FAA-sanctioned agreement for more than one owner to share the cost of operating a single aircraft. It differs from fractional ownership in that it is an agreement between private owners without the assistance or support of a fractional provider, such that the joint owners are directly responsible for all aspects of flight operations and aircraft maintenance. Joint ownership agreements have increased in popularity as the costs of private aviation have increased. Joint ownership agreements are somewhat a cross between fractional ownership and full ownership. They are far less flexible than a fractional interest, but generally are more cost effective per hour. Joint ownership agreements are an attractive alternative, assuming you can find a responsible and considerate partner, you can live with the fact that the aircraft may not always be available when needed, and you can secure a single aircraft that must be used for all purposes, regardless of need.

## Charter service

Chartering a plane, either directly from a charter company or through a charter broker, is often the most cost effective way to fly private. Chartering a plane provides flexibility and no up-front or ongoing commitment of capital. It is ideal when flight usage is sporadic or difficult to predict. It also allows you to select the size and type of aircraft that is best suited to each specific trip. Although use of charter brokers is often the least costly way to access private aviation, the flying experience can be inconsistent depending on the age and condition of the aircraft. Charter brokers generally own no planes themselves, but exist solely to match available aircraft with flying customers. They often take no responsibility for issues that arise after a flight has been arranged.

In certain ways, chartering may not be as convenient or consistent as some of the other options outlined above. You generally must schedule flights with more advance notice than a fractional share program requires and aircraft may be very difficult to charter (and more costly) during holidays and other peak usage periods. Charter operators are carefully regulated by the FAA and have strict safety standards to which they must adhere. However, there can be significant differences among charter operators in terms of the age, size, and condition of the fleet they have available. Generally speaking, the large national charter operators tend to have larger and newer fleets than local operators, increasing flexibility and consistency of service. Charter operators often have numerous add-on charges associated with their flights (e.g. fuel surcharges, pilot wait charges and landing fees). Charter companies also usually charge for deadhead hours when the plane has to travel to pick up passengers or return to its home base after dropping them off.

## Flight cards

The increasing use of flight cards has caused confusion for some. Fractional operators, charter companies and charter brokers all have some version of a flight card, but with significant differences. National charter operators also sell flight cards that are denominated in hours and represent a block of time on a specific type of aircraft. Charter brokers, on the other hand — since they often do not have a dedicated fleet of aircraft — denominate their flight cards in dollars instead of hours. The cards operate much like a gift card, with a dollar balance that is reduced by the actual cost of each flight until the balance reaches zero, at which time it can be "recharged."

Flight cards issued by charter companies and charter brokers are competitive with chartered flights, but generally add in various benefits, depending on what card is purchased. These benefits can include free catering, transportation to and from the airport, and shorter lead times when arranging a flight. Maintenance and safety under the flight card is consistent with chartering, and most card programs allow simultaneous use of multiple aircraft.

Flight cards issued by the fractional providers are typically more expensive per flight hour than actual fractional ownership hours, but they give nonowners access to the fractional fleet of aircraft. Because a flight card is simply block charter, there are no benefits of depreciation, which would be characteristic of fractional share ownership, joint ownership agreements, or full ownership.

**Deloitte Private Wealth**
*Sustain, enhance, and protect your wealth*

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