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Tax Reform – Like-Kind Exchanges: Steps for Aircraft Owners to Consider Before the End of 2017

SUMMARY

President Trump just signed into law the most significant tax reform legislation since 1986. This legislation, formerly known as the Tax Cuts and Jobs Act (“the Act”), impacts aircraft owners directly. Beginning in 2018, like-kind exchanges of aircraft (and other types of personal property) will no longer qualify for tax deferral. The Act contains a limited transition rule giving aircraft owners a very narrow window of opportunity to take advantage of current tax rules before they expire.

CONSIDER STARTING A LIKE-KIND EXCHANGE ON OR BEFORE DECEMBER, 31, 2017.

The Act limits the like-kind exchange rules to exchanges of real estate. Effective in 2018, like-kind exchanges of personal property, including aircraft, will no longer qualify as tax-deferred exchanges, but rather will be treated as taxable sales. In some cases, the loss of like-kind exchange treatment will be offset by the ability to claim 100 percent bonus depreciation with respect to the replacement aircraft. Bonus depreciation, however, has additional burdensome requirements that may preclude aircraft owners from taking advantage of it. For example, the requirement that aircraft be used predominantly for qualified business use can create roadblocks for owners who fall into the so-called “Leasing Company Trap” – the IRS practice of treating use by certain affiliates of the aircraft owner as personal use, even if such use is, itself, for a business purpose. Described another way, if aircraft owners lease their aircraft to another business or businesses they own wholly or in part, rather than operating it directly, they may be ineligible to claim bonus depreciation.

Aircraft owners considering replacing their aircraft in the near term may wish to consider starting a like-kind exchange before the end of 2017. The new like-kind exchange rules generally apply to exchanges completed after December 31, 2017, but under a special transition rule, the existing rules should continue to apply if the aircraft to be transferred as part of the exchange is “disposed of” on or before December 31, 2017 (even though the exchange has not been completed as of such date). Based on prior IRS guidance, property that is transferred to an “exchange accommodation titleholder” (EAT) as part of a qualified like-kind exchange is generally considered to have been transferred. Based on a literal interpretation of the transition rules and existing IRS guidance, aircraft owners may be able to take the position that the transfer of their existing aircraft to an EAT as the first part of a like-kind exchange is sufficient to satisfy the transition rule. It is possible, however, that the IRS may have a more restrictive interpretation of the transition rule.

Aircraft owners that delay until 2018 will have to pay federal income tax (and state tax, if applicable) as a result of depreciation recapture and/or gains, and try to meet the requirements for claiming bonus depreciation.

Saul Ewing Arnstein & Lehr LLP's Aviation Practice assists clients with like-kind exchanges of aircraft. We encourage you to consider whether such an exchange is advantageous for you. We also remind you that timing is of the essence in like-kind exchanges and that you will be subject to stringent requirements to identify and acquire a replacement aircraft once you dispose of your existing aircraft. Your access to and/or use of your aircraft may also be limited until it is replaced.

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