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Select Federal Tax Considerations for 2022 and Beyond

By William Borgmeyer

Starting in 2023, important changes are coming to the bonus depreciation rules that were put into effect with the 2017 Tax Cuts and Jobs Act (TCJA). Notably, the 100% bonus depreciation that many companies availed themselves to on aircraft purchases will begin its phase out. We provide a summary of these depreciation changes and also a reminder on other notable issues, passive loss limitations and the excess business loss limitations.

a. Depreciation

An aircraft owner may depreciate an aircraft's cost or other basis by using the straight-line depreciation method under the Alternative Depreciation System (ADS) or by using the Modified Accelerated Cost Recover System (MACRS). MACRS allows for the recovery of eligible property's cost or other basis faster than under the straight line method. The straight-line method divides the cost in equal parts during the recovery period of the aircraft until the aircraft is fully depreciated. The recovery period is determined by the primary use of the aircraft. The recovery period for an aircraft primarily used by an owner privately operated Part 91 is six years under ADS compared to 5 years under MACRS. The recovery period for a commercial use aircraft operated Part 135 is 12 years under ADS compared to 7 years under MACRS.

Under the TCJA, an aircraft that qualifies for MACRS may also be eligible for 100 percent bonus depreciation in the year in which the taxpayer places the aircraft in service. A taxpayer may still elect straight-line or regular accelerated MACRS. In order to qualify for MACRS and by extension 100 percent bonus depreciation, the aircraft must be operated predominately (50% or more) in a qualified business use. This is a two-step process, (1) at least 25% of total use must be qualified business use that does not involve leasing the aircraft to any 5% owners or related persons, and (2) if met, then all other business use may count toward meeting the 50% threshold.

The TCJA 100% bonus provisions apply only to aircraft acquired and placed in service after September 27, 2017 and before January 1, 2023. For tax years starting January 1, 2023, the bonus depreciation is phased down in increments of 20 percent until January 1, 2027. However, the placed in service date may be extended for one year to or certain longer production period property (LPPP) and "certain aircraft" that is acquired, or acquired pursuant to a written binding contract entered into before January 1, 2027. LPPP includes transportation property such as aircraft used in the trade or business of transporting persons or property. Certain aircraft generally includes aircraft that do not qualify as transportation property. For certain aircraft to qualify for the one year extension, the taxpayer must have made, at the time of contract for purchase, a non-refundable deposit of the lesser of 10 percent of the cost of the aircraft or \$100,000.

Owners may not take depreciation deductions for flight hours or miles devoted to personal use reasons such as entertainment, amusement, or recreation. Deductions are still available if the aircraft is used predominately for qualified business use. Owners must calculate the percentage of personal use

relative to business use by noting the names of each person on board, the reason for travel, and hours and miles of travel. These items assist in determining the entertainment disallowance which is a part of the cost basis of the aircraft that the owner cannot depreciate. If claiming 100 percent bonus depreciation, personal use, and passive use, of the aircraft should be avoided in the year placed in service. Especially for aircraft purchased late in the taxable year, taxpayers should avoid any personal or passive use of the aircraft in order to fully benefit from the deductions on their business aircraft.

Transition Rule for Property Placed in Service	Standard Rule	LPPP and Certain Aircraft
Sept. 28, 2017 - Dec. 31, 2022	100%	100%
Jan. 1, 2023 - Dec. 31, 2023	80%	100%
Jan. 1, 2024 - Dec. 31, 2024	60%	80%
Jan. 1, 2025 - Dec. 31, 2025	40%	60%
Jan. 1, 2026 - Dec. 31, 2026	20%	40%
Jan. 1, 2027 - Dec. 31, 2027	0%	20%

b. Passive Loss Limitation

The passive activity loss limitation rules apply to individuals, estates, trusts (other than grantor trusts), personal service corporations and closely held corporations. At the individual level, a taxpayer’s activities include those conducted through partnerships, S corporations, or closely-held or personal service corporations. There are two kinds of passive activities limited by IRC Section 469: (1) trade or business activities in which the taxpayer does not materially participate during the year; and (2) rental activities, even if the taxpayer does materially participate, unless the activity is rental real estate and the taxpayer is a real estate professional. Rental activities of tangible personal property are a per se passive activity, a taxpayer’s material participation in the rental activity is not taken into account to determine its passive nature.

A lease to a Part 135 certificate holder for charter operations generally will be considered a passive activity due to its consideration as a rental activity. In some cases, a lease for Part 91 use from a disregarded entity to a parent company for use in its trade or business may not be considered a rental activity and therefore a nonpassive loss.

Losses generated from a passive activity generally cannot be used to offset income earned from business or investment activities. Any disallowed losses are treated as a deduction allocable to that passive activity in future years. Once the taxpayer disposes of his entire interest in the passive activity, any unused passive activity losses over net income or gain from other passive activities are not treated as passive and deductible against other income.

c. Excess Business Loss Limitation

An excess business loss limitation is defined as the amount by which the aggregate deductions of the taxpayer attributable to trades or businesses exceed the sum of the aggregate gross income or gain attributable to trades or businesses plus a threshold amount (\$270,000, or \$540,000 in the case of joint return for 2022). Any losses in excess of the threshold amount are disallowed and treated as a net operating loss carryover to the following taxable year. The net operating losses in future years are only limited by the 80% income cap on net operating losses.