Are you a Certified Aviation Manager or interested in earning points towards your initial application?

Today’s presentation is eligible for Certified Aviation Manager (CAM) Initial and Recertification points (1/4 point).
Nel Stubbs

Nel has her Bachelor’s in Mathematics and Masters in Aeronautical science. She is also a Vice President and Co-Owner of Conklin & de Decker, an aviation information services company specializing in aircraft costs, financial planning, tax planning, fleet planning, aviation tax issues, financial, tax & aircraft acquisition planning seminars and maintenance management software.

Nel created the NBAA Tax Committee and served as the committee liaison until 1999. She still serves on that committee as well as the NATA Air Charter Committee & HAI Finance and Leasing Committee. Nel also serves on the NBAA AMAC committee and the NAFA Board of Directors. Nel is a frequent speaker at several industry events.

Dave Weil

Dave is the CEO of Flight Dept Solutions, LLC, a business aviation consulting firm focused on assisting aircraft owners in many areas, including aircraft acquisition-related services, selecting or monitoring management companies, establishing or supporting flight departments and financial management. He is a CPA and an MBA.

Dave is a Past Chairman of the NBAA Tax Committee and has spoken at various NBAA events in the past. Previously Dave served in senior executive positions with several prominent aircraft management companies, including TAG Aviation USA and TAG Aviation Asia.
DISCLAIMER

This presentation is intended to provide general information about aviation regulations, taxes, depreciation, accounting, budgeting and related issues. Such information should not be relied upon as a substitute for accounting, legal or tax advice from an experienced advisor, who has applied the applicable rules to the specific facts and circumstances of your particular situation. You should ask your chosen advisor to provide you with advice in a form that you can rely upon before you acquire or operate an aircraft or enter into any transaction. Information contained herein and any information that you have otherwise received from us was neither intended nor written to be used and cannot be used for the purpose of avoiding tax penalties under U.S. law or for promoting, marketing or recommending to another party any tax related matters.
Topics to be Reviewed & Covered

1. Introduction & Assumptions
2. Important Terms
   a. Depreciation
      i. Financial/Book, Market & Tax
   b. Variable Costs vs Fixed Costs
   c. Chart of Accounts
3. Flexible Budgets
4. Tax Accounting Compliance Issues
5. FAA/IRS Accounting Issues
Introduction & Assumptions

• **Introduction**
  – The overall purpose of this presentation is to introduce attendees to the basics of Financial & Tax accounting and Budgets related to a flight department.

• **Primary Assumptions:**
  • Part 91 *internal* corporate flight department with one aircraft
  • Aircraft owner is a U.S. corporation conducting business worldwide
  • Aircraft primarily used for business
Important Terms

- **Financial /Book Accounting** –
  - Used to produce financial statements given to investors and lenders, based on “generally accepted accounting principles” (i.e. GAAP).

- **Tax Accounting** –
  - Used to produce tax returns given to the IRS, based on the U.S. tax code.

- **Budget** –
  - A financial plan that is used to estimate the financial results of future operations.

- **Capital or Depreciable Asset** –
  - Tangible item that has a useful life greater than the current accounting period (e.g. an aircraft).
Important Terms (continued)

• **Expense** –
  • A “Gone Asset” or expired cost, short term life (e.g. fuel cost).

• **Depreciation for Financial Accounting** –
  • aka Book Depreciation, is a system which aims to distribute the cost or other basic value of tangible assets, less any salvage value over the estimated useful life of the asset in a systematic and rational manner.
  – Straight line depreciation is the most widely used method.
  – See example below.
Important Terms (continued)

• **Depreciation for Financial/Book Accounting**
  – Example
  
  • *Depreciation charge* = acquisition cost – estimated salvage value / estimated useful life.
  
  • *Most companies have policies on what the “estimated useful life” should be (e.g. 10 years for aircraft).*
  
  • $2,200,000 - 200,000 (salvage value) = $2,000,000
  
  • $2,000,000/10 = $200,000/year depreciation expense for 10 years for Financial Accounting Purposes
Important Terms (continued)

• **Market Depreciation** –

  • Is a widely changing variable based on the value of the aircraft in the marketplace. Until an aircraft is sold no one really knows the exact value of the aircraft. Therefore until the aircraft is sold market depreciation is an estimate. Market depreciation percentages are based on historical residual values.

    – **Pre-Recession** – residual value used was 3%-4% per year for jets.

    – The difference between Retail and Wholesale was not that significant because of the demand.
Important Terms (continued)

• **Market Depreciation** (cont’d)
  
  – **Post Recession** *(Conklin & de Decker)*
    
    • **New Aircraft**
      
      • Residual Value with no inflation on a *new* aircraft is on average 76% of purchase price the first year and dropping on average 6% per year, for jets, thereafter. At 10 years the aircraft value could be 40% of the new purchase price. This is without any inflation, therefore in today’s dollars.
        
        • One reason for this is because you buy at Retail and sell/trade-in at Wholesale.
  
    • **Used Aircraft**
      
      • First year drop not quite as significant as a new aircraft, but the 2nd or 3rd year may make up for this.

  – **Time will tell.**
Important Terms (continued)

• **Depreciation for Tax Accounting** –

• Tax depreciation is the annual deduction allowed to recover the cost or other basis of business property with a useful life of more than one year. – **Tax Depreciation IRS Code Section 168**

  – **For Tax Return Purposes.** The Modified Accelerated Cost Recovery System (MACRS) is mandatory for most tangible depreciable property placed in service after December 31, 1986. Property is depreciable if it wears out, has a determinable life that exceeds one year, and is used in a trade or business or for the production of income. A deduction is allowed for a reasonable allowance for the exhaustion, wear and tear of property used in the business.
Important Terms (continued)

• Under MACRS
  – Aircraft that are used primarily for commercial (Part 135) purposes are depreciated over 7 years.
  – Non-Commercial (Part 91) aircraft, and all helicopters, are depreciated over a 5 year period
**IRS Depreciation Percentage Rates**

<table>
<thead>
<tr>
<th>Year</th>
<th>5 Yr Life</th>
<th>7 Yr Life</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>20.00%</td>
<td>14.29%</td>
</tr>
<tr>
<td>2</td>
<td>32.00%</td>
<td>24.49%</td>
</tr>
<tr>
<td>3</td>
<td>19.20%</td>
<td>17.49%</td>
</tr>
<tr>
<td>4</td>
<td>11.52%</td>
<td>12.49%</td>
</tr>
<tr>
<td>5</td>
<td>11.52%</td>
<td>8.93%</td>
</tr>
<tr>
<td>6</td>
<td>5.76%</td>
<td>8.92%</td>
</tr>
<tr>
<td>7</td>
<td></td>
<td>8.93%</td>
</tr>
<tr>
<td>8</td>
<td></td>
<td>4.46%</td>
</tr>
</tbody>
</table>
Important Terms (continued)

- **Variable Costs** –

- As activity increases, the total cost will increase but the cost per unit of measure will remain constant. (*e.g. fuel cost varies directly with the number of flight hours and so does the cost for engine maintenance programs, landing fees, catering, crew expenses, etc.*)
Important Terms (continued)

• **Fixed Costs** –

• For a given level of activity or period of time, the total cost remains constant. *(e.g. insurance cost is “fixed” and does not vary directly with the number of flight hours, training, crew salaries, hangar, management fee, etc)*
Important Terms *continued*

- **Chart of Accounts** –
  - A list of accounts used to categorize all expenditures for accounting purposes.
  - At the company level this may just be 1 line titled - Aviation Department. It may be up to you to show where all the money is spent.

Sample piece - Expenses - Aircraft Variable - *This category includes all expenses associated with the aircraft that vary as a function of hours flown. Expenses should be recorded by tail number.*

<table>
<thead>
<tr>
<th>Code</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>61100</td>
<td>Fuel, Fuel Additives and Lubricants</td>
</tr>
<tr>
<td>• 61110</td>
<td>Fuel</td>
</tr>
<tr>
<td>• 61112</td>
<td>Fuel - Bulk</td>
</tr>
<tr>
<td></td>
<td>Fuel obtained from a fuel tank farm or on a major contract</td>
</tr>
<tr>
<td>• 61114</td>
<td>Fuel - Other</td>
</tr>
<tr>
<td></td>
<td>All other fuel</td>
</tr>
<tr>
<td>• 61120</td>
<td>Lubricants and Fuel Additives</td>
</tr>
</tbody>
</table>
Flexible Budget

• A Flexible Budget is a type of budget that is easily revised to reflect changes in activity levels.
  – For example, a flexible budget can be easily adjusted to reflect a change in estimated flight hours from 300 to 450 hours per year.

• A Flexible Budget for an aircraft is setup to allow the Variable Costs to be easily adjusted as the number of estimated flight hours changes.
  – For example, the Variable Costs are budgeted to be $3,000 per flight hour so as the number of flight hours changes, the Variable Cost part of the budget changes.

• Refer to separate Flexible Budget example file.
### Flexible Budget Sample Format

#### Variable Costs Budget Example

<table>
<thead>
<tr>
<th></th>
<th>Assumed Flight Hours per Year</th>
<th>Jan-12</th>
<th>Feb-12</th>
<th>Mar-12</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Direct Operating Costs (DOCs)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aircraft Fuel and Oil</td>
<td>2,000</td>
<td>60,000</td>
<td>60,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Airframe and APU reserve</td>
<td>150</td>
<td>4,500</td>
<td>4,500</td>
<td>4,500</td>
</tr>
<tr>
<td>Communications</td>
<td>50</td>
<td>1,500</td>
<td>1,500</td>
<td>1,500</td>
</tr>
<tr>
<td>Scheduled Maint and Repairs</td>
<td>200</td>
<td>6,000</td>
<td>6,000</td>
<td>6,000</td>
</tr>
<tr>
<td>Engine Program</td>
<td>300</td>
<td>9,000</td>
<td>9,000</td>
<td>9,000</td>
</tr>
<tr>
<td>Flight Crew Expenses</td>
<td>200</td>
<td>6,000</td>
<td>6,000</td>
<td>6,000</td>
</tr>
<tr>
<td>Flight Crew Meals</td>
<td>50</td>
<td>1,500</td>
<td>1,500</td>
<td>1,500</td>
</tr>
<tr>
<td>International Handling</td>
<td>350</td>
<td>10,500</td>
<td>10,500</td>
<td>10,500</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>150</td>
<td>4,500</td>
<td>4,500</td>
<td>4,500</td>
</tr>
<tr>
<td><strong>Total Variable Costs</strong></td>
<td>3,450</td>
<td>103,500</td>
<td>103,500</td>
<td>103,500</td>
</tr>
</tbody>
</table>
### Flexible Budget Sample Format

#### Fixed Operating Costs Example

<table>
<thead>
<tr>
<th>Fixed Operating Costs</th>
<th>Jan-12</th>
<th>Feb-12</th>
<th>Mar-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aircraft Insurance</td>
<td>60,000</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Property Taxes</td>
<td>0</td>
<td>0</td>
<td>35,000</td>
</tr>
<tr>
<td>Contract Labor</td>
<td>4,000</td>
<td>4,000</td>
<td>4,000</td>
</tr>
<tr>
<td>Salaries - Maint/Pilots/Flt Att</td>
<td>36,000</td>
<td>36,000</td>
<td>36,000</td>
</tr>
<tr>
<td>Benefits - Salaried Employees</td>
<td>10,080</td>
<td>10,080</td>
<td>10,080</td>
</tr>
<tr>
<td>Hangar &amp; Crew Office</td>
<td>5,000</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Flight Crew Training</td>
<td>0</td>
<td>0</td>
<td>18,000</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>2,000</td>
<td>2,000</td>
<td>2,000</td>
</tr>
<tr>
<td><strong>TOTAL Fixed Expenses</strong></td>
<td>117,080</td>
<td>57,080</td>
<td>100,080</td>
</tr>
</tbody>
</table>
Tax Accounting Compliance Issues

– Depreciation
– Personal Use/SIFL
– Entertainment Use
Tax Accounting Compliance Issues

- **Tax Depreciation**
  - A business aircraft owner is allowed an annual deduction on its income tax return for depreciation
    - business aircraft are used in a “trade or business” and are subject to “exhaustion, wear and tear, and obsolescence” over time (IRC §167)
  - Depreciation deductions reduce the tax basis on a dollar for dollar basis until the basis has been reduced to zero
  - Depreciation deductions are only allowed on the business use of an aircraft
    - Transporting taxpayer’s own personnel and property
    - Leasing without crew
    - Commercial or contract carrying of passengers or freight
Tax Accounting Compliance Issues

- **Personal Use/SIFL**
  - Determine Personal Use Benefit Value = to charter rate or safe harbor rule (SIFL)
  - DOT per mile rates (statute miles) and terminal charge published semi-annually
  - Need to know aircraft weight and passengers status in company, Control or Non-control employee
  - Passenger needs to have connection with company, receives W-2 or 1099 to include the value of the flight as income. Guest’s value charged to employee passenger
  - Income taxes including FICA taxes are paid on the value of the trip, NO CASH REIMBURSEMENT
Tax Accounting Compliance Issues

- **Entertainment Use**
  - Business income tax deductions are reduced (disallowed) when an airplane is used for personal entertainment purposes I.R.C. 274(e)(2)
  - All expenses of operating the aircraft including fixed and variable expenses are subject to disallowance including salaries, fuel, maintenance, hangar, trip expenses, insurance, depreciation (straightline), lease payments, etc. and interest if debt is secured by the aircraft. If aircraft is leased, then the lease payment.
**FAA/IRS Accounting Compliance Issues**

- **Charging for Personal Use**
  - FAA – limited allowed personal use charging options – Timeshare Agreement (lease) & FAA Chief Counsel Opinion
    - Timeshare Agreement – allowed charges listed in FAR 501.91(d). Basically can charge for twice the cost of fuel, catering, crew T&E and airplane trip expenses
    - FAA Opinion – update to the Schwab Opinion, can reimburse for certain entertainment trips. Company Board needs to be able to “cancel the trip” in order to reimburse also needs to have a list of approved staff. Can reimburse for vacation flights but not for medical trips, funerals, weddings, etc.
  - IRS - Federal Excise Taxes (FET) taxes to be paid any time there is a CASH reimbursement
Question & Answer Session