

Business Aviation Tax Provisions in the CARES Act

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The Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136) was signed into law on March 27, 2020. It includes numerous relief provisions that may benefit companies operating business aircraft. In addition, the CARES Act provides a tax holiday for the remainder of 2020 from the Federal Excise Tax on air transportation and amends several income tax code sections that may affect owners and operators of business aircraft.

Given the complexity of these tax law amendments, this resource offers only a general description of the amendments. For details regarding the calculations and their application to fiscal years, please refer to the statute.

Federal Excise Tax (CARES Act § 4007; I.R.C. § 4261)

The CARES Act provides that the Federal Excise Tax (FET) on air transportation under Internal Revenue Code (I.R.C.) §§ 4261 and 4271 does not apply to amounts paid during the excise tax holiday period from the day after enactment of the CARES Act (i.e., from March 28, 2020) through the end of calendar year 2020. This means that FET does not need to be collected on amounts paid for charter flights, time share flights, or any other flights, irrespective of whether the flights are conducted under FAA Regulations Part 91, 135 or otherwise.

During this excise tax holiday period, no fuel tax will be required to be collected on jet fuel used for commercial aviation. If fuel tax is collected on kerosene used for commercial aviation, then the purchaser can request a refund of such fuel tax. The foregoing exemption does not apply to the 0.1 cent per gallon Leaking Underground Storage Tank (LUST) tax. This means that only the 0.1 cent LUST tax is ultimately due on fuel purchased for commercial aviation.

The definition of commercial aviation for tax purposes is generally based on whether air transportation is provided for compensation or hire, and it is not tied to the FAA Regulatory definition. I.R.C. § 4083(b). Accordingly, only the 0.1 cent LUST should ultimately apply to typical charter flights and flights conducted pursuant to a time sharing agreement. However, the full fuel tax amount (21.9 cents or 24.4 cents per gallon) would apply to fuel purchased for use in noncommercial operations such as when a company purchases fuel for use in operating its aircraft for flights conducted for its own business.

Fuel purchased for fractional program aircraft is subject to the fuel tax on fuel used for noncommercial aviation (21.9 cents or 24.4 cents per gallon) plus a surtax of 14.1 cents per gallon. Since the excise tax holiday does not apply to fuel for noncommercial aviation or the surtax, the fuel taxes paid by fractional program operators would not appear to be affected by the excise tax holiday.

Limitation on Deduction of Business Interest (CARES Act § 2306; I.R.C. § 163(j))

Under the Tax Cuts and Jobs Act (TCJA) (P.L. 115-97) beginning in 2018, taxpayers' deductions of business interest expense were limited to 30% of adjusted taxable income (generally net business income). The excess business interest was not deductible and was treated as business interest expense subject to the limitation in the next year.

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Although the deduction limitation applied beginning in 2018, adjusted taxable income is calculated without deducting depreciation in 2018 through 2021. In the case of partnerships and S corporations, the interest deduction limitation was determined at the entity level. The deduction limitation generally did not apply to taxpayers with gross income below \$25 million (determined by aggregating income of related entities).

This limitation is particularly important in the case of business aircraft that are financed. After the three-year grace period during which depreciation is not deducted in calculating adjusted taxable income, this limitation will become even more relevant to business aircraft.

The CARES Act increases the interest deduction limit from 30% of adjusted taxable income to 50% of adjusted taxable income in 2019 and 2020. This temporary increase in the limitation provides some relief to owners of business aircraft. (Taxpayers can elect out of this increased deduction limit.)

There is an exception to this temporary relief in the case of partnerships (although not for S corporations). While the 50% limit applies to partnerships in 2020, it does not apply to partnerships in 2019. Instead, a special limitation applies to partnerships in 2019. Under the special rule, the 30% limit applies, and if the partnership has any excess business interest expense, 50% of the excess is allowed as deductible business interest in 2020 (unless the partner elects out of this special rule). The other 50% of excess business interest is carried over like other excess business interest.

Taxpayers can also elect to use their 2019 adjusted taxable income to calculate their business interest deduction limitation for 2020. This special rule provides some relief for taxpayers whose taxable income decreases in 2020.

Net Operating Losses (CARES Act § 2303; I.R.C. § 172)

Owners of business aircraft may incur Net Operating Losses (NOLs), particularly due to large depreciation deductions. Under the TCJA, effective generally with respect to NOLs arising in 2018 or subsequent years, NOLs could only be carried forward (not back) and could be deducted against only 80% of taxable income in future years. Under the CARES Act, these limitations are temporarily relaxed.

Under the CARES Act, NOL carryforwards can offset 100% of taxable income in 2020 or earlier years. In 2021 and later years, taxpayers can deduct: (1) NOL carryforwards arising in 2017 and earlier years against 100% of their taxable income (because the TCJA 80% limit did not apply to NOLs arising in 2017 and earlier years), and (2) NOL carryforwards arising in 2018 and later years against up to 80% of their taxable income. Also under the CARES Act, NOLs arising in 2018, 2019, and 2020 can be carried back 5 years. Allowing NOL carrybacks can be particularly valuable to corporations in view of the higher corporate income tax rates prior to 2018.

Excess Business Losses (CARES Act § 2304; I.R.C. § 461(l))

Beginning in 2018 under the TCJA, individuals' deductions of net business losses were limited to \$250,000 for single taxpayers and \$500,000 for married taxpayers. Their excess business losses were carried forward as NOLs. In the case of partnerships and S corporations, this loss limitation was imposed at the partner or shareholder level. The business losses subject to this rule included active trade or business losses and any otherwise allowed passive losses.

This provision can be especially important to business aircraft owners who incur large depreciation deductions that result in business losses. However, since excess business losses were carried forward as NOLs, and as NOLs they were not subject to the excess business loss limit in future years, the limitation on excess business losses often resulted in only a one-year delay in the deduction.

Nevertheless, the excess business loss limitation was problematic for taxpayers who reported large capital gains from the sale of a business in the same year that they incurred large business losses from depreciation deductions on aircraft. In that situation, the excess business loss from aircraft depreciation would result in NOL carryforwards to future years, which may not be deductible if the taxpayer had no significant business income in future years.

Under the CARES Act, the excess business loss limitation is retroactively amended so that it does not apply in 2018, 2019, and 2020. Instead, it first applies in 2021.

The CARES Act also made changes to the excess business loss calculation, which will become relevant when the limitation applies in 2021. The calculation of net business losses that could be taken into account under the TCJA appeared to include salaries and wages income, but the CARES Act clarifies that such income is excluded from the calculation. In addition, the CARES Act clarifies that gains from sales of capital assets are only included if such gains are attributable to a trade or business, and losses from sales of capital assets are excluded entirely.