



CORPORATE JET INC PROVIDES NO TAX OR LEGAL ADVICE!

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Section 1031 of the Internal Revenue Code

Section 1031 of the Internal Revenue Code provides for the exchange of "personal property" presenting a substantial tax deferral opportunity for business owners. "Personal property", for the purposes of 1031 exchanges, includes any tangible depreciable capital asset, other than real property, which is held for use in a trade or business or investment.

Aircraft Exchanges

The sale of an aircraft used for business purposes presents both a unique challenge and unique opportunity for taxpayers. Aircraft are often worth more upon resale than their original purchase price and, in addition, often have a substantially reduced adjusted tax basis because of rapid depreciation schedules. Fortunately, Section 1031 is available to the owners of business use aircraft to defer both the recognition of capital gains taxes and the recapture of depreciation, thereby preserving the taxpayer's equity from the sale for purchase of a replacement aircraft.

To comply with the requirements of Section 1031 and the Regulations, an exchange of aircraft must meet the same general requirements as any tax-deferred exchange. In the exchange of an aircraft, these general requirements include the following:

Exchange of Like Kind Property

Aircraft acquired as "replacement property" must be "like kind" with the aircraft relinquished in the exchange. Fortunately for taxpayers desiring to exchange business aircraft, the Regulations provide that all aircraft and helicopters not used in the commercial or charter transportation of passengers or cargo are included in the same General Asset Class #00.21 and considered to be "like kind". The exchange of aircraft used in commercial or charter transportation is also possible, as well as engines and other aircraft component

Exchange of Qualifying Use Property

The aircraft relinquished in the exchange and the replacement aircraft must be held for use in a trade or business or for investment. Aircraft owners, where individual or corporate, can comply with this requirement if the aircraft are used in the course of the owner's business, with any personal use being a secondary and smaller portion of the log time. In addition, collectible aircraft may also meet this requirement if the collector has an investment intent.

Reinvestment Requirements

Defer all of the capital gains in an aircraft exchange, the "exchange value" (purchase price plus closing costs) of the aircraft acquired must equal or exceed the exchange value of the aircraft relinquished in the exchange (sales price less costs of sale, including commissions). In addition, all of the equity in the relinquished aircraft (net sales proceeds) must be reinvested in the replacement aircraft.

In addition to complying with the general requirements of Section 1031 and the Regulations, exchanges of aircraft have unique issues in the context of a tax deferred exchange:

- Most states impose substantial sale taxes on transactions involving aircraft within the state, or use taxes on aircraft that are located for tax purposes within their jurisdiction. However, some states which assess sales taxes have an exemption for aircraft sales when the aircraft is removed from the state within a short period of time (usually a few days) after the sale. In other cases, states which assess a use tax on aircraft located in their jurisdiction will usually allow a credit for sales taxes paid to another state.
- The procedures for transferring title, documenting purchase financing and security interests, and registration with the FAA, are unique to the sale and purchase of aircraft.
- Section 1031 prohibits the exchange of domestic personal property for foreign personal property on the basis such properties are not like kind to one another. Special rules determine whether aircraft are "domestic" or "foreign" for the purposes of a 1031 exchange. Determination of an asset's location for tax purposes is often a key issue in the successful completion of a tax-deferred exchange of aircraft.

General and Identification Requirements

In addition to the more specific requirements discussed above, an aircraft exchange must also comply with the general requirements for all 1031 exchanges provided by the I.R.S. Regulations, including the use of an independent qualified exchange intermediary, a 45 day deadline for the identification of the replacement aircraft, and a 180 day deadline for completion of the exchange. The I.R.S. Regulations require that the identification of property to be received in the exchange must specifically describe a particular type of personal property. In an aircraft exchange, an acceptable description would include the specific make, model and year of the replacement aircraft. An exchange of an existing aircraft for one yet to be produced is possible, so long as the replacement aircraft is identified properly, and it is completed and delivered to the taxpayer within the 180 day exchange deadline.

Reverse and Improvement Exchanges

In an "improvement" exchange, a taxpayer may exchange an aircraft for one which the taxpayer desires to overhaul or upgrade (such as with new engines or interior), and include the improvements in the exchange value of the aircraft. In a "reverse exchange", an aircraft may be acquired as the replacement property in an exchange before the sale of the relinquished aircraft. Such reverse exchanges have been sanctioned by the I.R.S., which has provided specific requirements in Revenue Procedure 2000-37 for a valid reverse exchange.

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