

TAM 9217006

Date: January 2, 1992

Control Number: TR-32-256-91

Chief, Appeals Office: * * *

Taxpayer's Name: * * *

Taxpayer's Address: * * *

Identification No.: * * *

Years Involved: * * *

Date of Conference: * * *

LEGEND:

Owner = * * *

Taxpayer = * * *

Retail = * * *

Airplane = * * *

ISSUE

Taxpayer has claimed accelerated depreciation and the investment tax credit on Airplane purchased for leasing to a related "S Corporation." To determine if Taxpayer qualifies for the deduction and the credit, the Appeals Office has asked for a technical advice memorandum to answer the following issues:

(1) Whether Airplane, leased by an "S Corporation" to a related "S Corporation," is excluded from the rules for listed property under either section 280F(c)(1) or 280F(d)(4)(C) of the Internal Revenue Code.

(2) Whether leasing of Airplane by "S Corporation" to a related "S Corporation" is qualified business use for section 280F(d)(6) of the Code.

On issue #1, the pivotal question is whether the leasing of Airplane or the provision of transportation services for hire by Taxpayer could exclude Taxpayer's Airplane from the listed property rules.

On issue #2, Airplane is eligible for accelerated depreciation and the investment tax credit only if Airplane is predominantly used in a qualified business use. In tabulating the annual business use of Airplane, a side issue is whether standby time, when Airplane is not flying, counts in determining the percentage of qualified business use.

FACTS

The facts as we understand them are as follows:

Taxpayer is an S Corporation holding ownership of Airplane. For the years at issue, * * * Taxpayer claimed * * * investment tax credit and accelerated depreciation deductions on Airplane.

Retail, a retail business with sales of building and home improvement materials at * * * outlets located in * * * states, is the ongoing and principal "S Corporation" of Owner. Owner held percent of the stock in Retail and * * * percent of the stock in Taxpayer.

Because Retail's operations were located over a large geographic area, Retail determined that the amount of travel time expended by employees could be decreased and cost savings achieved by purchase of an aircraft. In * * * Airplane was purchased and placed in service by Taxpayer, a new "S Corporation" created to own and operate Airplane. Airplane was "leased" to Retail and other parties. Prior

to *** Airplane was piloted by contract personnel. In *** Taxpayer hired a pilot and received an *** to operate Airplane as a commercial carrier.

More than *** percent of the total use of Airplane was accounted for by Retail. Also, more than *** percent of the total use of Airplane was by employees of Retail who were unrelated to Owner's family, possessed no significant ownership of stock in Retail, and who used Airplane solely in the management and coordination of Retail's business. Use by Owner's son, who was both an employee of Retail and a related person, was counted separately from the other employees of Retail and, therefore, was not included in the count of business use of Airplane by employees of Retail.

The use of Airplane by unrelated persons, other than employees, was occasional, incidental, minimal, and without written lease agreements or contracts between Taxpayer and the unrelated persons.

The use of Airplane by Owner and by members of Owner's family amounted to less than *** percent of total use in each of the years at issue.

LAW

Section 280F of the Code sets forth special rules for the depreciation deduction and investment tax credit applicable to items of listed property.

Section 280F(d)(4)(A)(ii) of the Code includes as listed property any means of transportation other than any passenger automobile (identified in 280F(d)(4)(A)(i)). Generally, an aircraft is listed property subject to the requirements in section 280F. However, section 280F(d)(4)(C), except to any extent provided in regulations, excludes an aircraft from listed property in instances where substantially all of the use of the property is in a trade or business of providing to unrelated persons services consisting of the transportation of persons or property for compensation or hire. In addition, section 280F(c)(1) provides that section 280F shall not apply to any aircraft leased or held for leasing by any person regularly engaged in the business of leasing such property. Section 1.280F-5T(c) of the temporary Income Tax Regulations disallows occasional or incidental leasing activity as proof of regular leasing and permits the exclusion only for leasing contracts entered into with some frequency over a continuous period of time.

For any listed property not predominantly used in a qualified business for any tax year, section 280F(b)(1) and (2) of the Code disallows the use of accelerated

depreciation and the investment tax credit and requires computation of the depreciation deduction to follow the straight line method allowed under section 168(g).

If property is predominantly used in a qualified business use in the year it is placed in service, but in any subsequent year the property is not predominantly used in a qualified business use, section 280F(b)(3)(A) of the Code requires that any excess depreciation be recaptured and included in gross income for the tax year when the property is not predominantly used in a qualified business use. Section 280F(b)(3)(B) clarifies excess depreciation as meaning the excess (if any) of the amount of depreciation deductions allowable with respect to the property for tax years before the first tax year in which the property was not predominantly used in a qualified business use over the amount that would have been so allowable if the property had not been predominantly used in a qualified business use for the tax year in which it was placed in service.

Section 1.280F-6T(d)(2)(i) of the temporary regulations generally defines a "qualified business use" of listed property as any use in a trade or business of the taxpayer. The term "qualified business use" does not include use for which a deduction is allowable under section 212 of the Code. For the accelerated percentages under section 168 to be available for listed property, the amount of qualified business use must exceed 50 percent of total use of the listed property.

Under the general rule of section 280F(d)(6)(C)(i) of the Code, excluded from qualified business use is the leasing of property to any 5-percent owner or related person, or the use of property provided as compensation for the performance of services by a 5-percent owner or related person. However, when at least 25 percent of the total use of an aircraft during the tax year consists of qualified business use exclusive of the compensatory use or leasing described in section 280F(d)(6)(C)(i), section 280F(d)(6)(C)(ii) provides a special rule allowing the uses described in section 280F(d)(6)(C)(i) to be included as qualified business use of the aircraft.

Section 1.280F-6T(d)(2)(ii)(A) of the temporary regulations distinguishes the use of listed property by an individual who is a related party to, or 5-percent owner of, the lessor or lessee of the property. The effect of this is to allow use by other individuals to be qualified business use. Thus, the use of an aircraft by individuals who are not related parties or 5-percent owners with respect to the owner or lessee

of the aircraft constitutes qualified business use for the 25-percent-qualifying-business-use test in section 280F(d)(6)(C)(ii) of the Code.

Section 280F(d)(6)(D)(ii) of the Code defines a related person as any person related to the taxpayer (within the meaning of section 267(b)). Section 267(b)(1) defines individual members of a family as related, while section 267(b)(2) defines as related persons an individual and a corporation with more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual. Similarly, section 267(b)(11) defines related persons as an S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation.

Section 280F(d)(6)(D)(i) of the Code specifies that the term "5-percent owner" means any person who is a 5-percent owner with respect to the taxpayer (as defined in section 416(i)(1)(B)(i)). Section 416(i)(1)(B)(i) defines the term "5-percent owner," in the case where the employer is a corporation, as any person who owns (or is considered as owning within the meaning of constructive ownership of stock) more than 5 percent of the outstanding stock of the corporation or stock possessing more than 5 percent of the total combined voting power of all stock of the corporation.

Section 274(d)(4) of the Code disallows any deduction or credit in the absence of substantiation by a taxpayer on the use of an airplane considered to be listed property under section 280F(d)(4). Adequate substantiation requires adequate taxpayer records or sufficient evidence corroborating the taxpayer's own statement as to use of the airplane. For listed property such as an aircraft, section 1.274-5T(b)(6)(i)(B) of the temporary regulations describes the appropriate measure of the business investment use to be mileage.

Section 49(a) of the Code, added by the Tax Reform Act of 1986, limited the amount of the regular percentage of the investment tax credit determined under section 46, to tangible personal property placed in service prior to December 31, 1985.

RATIONALE

In general, any aircraft is listed property under section 280F(d)(4)(A)(ii) of the Code. As listed property, section 280F(b) requires Airplane to be predominantly used in a qualified business use to be eligible for accelerated depreciation and the investment tax credit.

However, if Airplane is excepted from the rules for listed property, then Airplane is eligible for accelerated depreciation and the investment tax credit regardless of the qualified-business-use test. Under Taxpayer's set of facts, Airplane may be exempted from listed property if use of the Airplane satisfies either or both of the exceptions described in section 280F(c)(1) and 280F(d)(4)(C) of the Code. Airplane would be exempt if the Airplane were held for leasing by any person regularly engaged in the business of leasing such property. Alternatively, Airplane would be exempt if substantially all the use of the Airplane were to be in providing to unrelated persons services consisting of transportation of persons or property for compensation or hire.

AIRPLANE IS NOT EXCEPTED FROM LISTED PROPERTY RULES BY SECTION 280(F)(c)(1)

Section 280F(c)(1) of the Code excludes from section 280F treatment any listed property leased or held for leasing by any person regularly engaged in the business of leasing that property. Section 1.280F-5T(c) of the temporary regulations elaborates on whether a person is regularly engaged in leasing for section 280F(c)(1). It specifies that a person shall be considered regularly engaged in the business of leasing the listed property only if contracts to lease the property are entered into with some frequency over a continuous period of time. Further, occasional or incidental leasing activity is not proof that a property is used regularly in the trade or business of leasing.

Taxpayer's use of Airplane did not meet the criteria for "regularly engaged in the business of leasing" in section 1.280F- 5T(c) of the temporary regulations. Airplane was used by and was predominantly available only to individuals and operations associated with either Retail, Owner, or related parties; any use by unrelated parties was minimal. For these uses, Taxpayer did not enter into formal lease agreements. The use of Airplane is not evidenced by lease contracts entered into with some frequency over a continuous period of time. Thus, Taxpayer cannot be said to have been in the business of regularly leasing of Airplane for purposes of section 280F(c)(1) of the Code, and Airplane is not excepted from the listed property rules by that section.

AIRPLANE IS NOT EXCEPTED FROM LISTED PROPERTY RULES BY SECTION 280F(d)(4)(C)

Section 280F(d)(4)(C) of the Code provides an exception to the listed property rules for listed property used in the business of transporting persons or property for

compensation or hire. Although this section was added to the Code by section 1812(e)(4) of the Tax Reform Act of 1986, it is effective for 1985 and 1986. This exception is applicable only if substantially all the use of the listed property is for providing services to unrelated persons.

As an owner of more than 5-percent of the outstanding stock in Taxpayer and Retail, the Owner was 5-percent owner of both under section 416(i)(1)(B)(i) of the Code. In addition, Owner's possession of more than * * * of the stock ownership in both Taxpayer and Retail meant that Owner, Retail, and Taxpayer were all related parties to one another according to section 267(b)(11).

Under Taxpayer's set of facts, if it was in the business of providing transportation services with Airplane, rarely were these services to any person other than a related person. Any such service substantially was to related S Corporations and to the principal owner of the S Corporations. Because substantially all of any such service was for related parties, Airplane was not excepted from the listed property rules by section 280F(d)(4)(C) of the Code.

WAS THERE QUALIFIED BUSINESS USE OF AIRPLANE?

In concluding previously that Airplane was not excluded from the listed property rules of section 280F of the Code, we concluded that Taxpayer was not regularly engaged in the business of leasing Airplane for purposes of section 280F(c)(1) of the Code. We did not, however, reach any conclusion on whether Taxpayer was in the business of leasing. Taxpayer was eligible for the accelerated depreciation and the investment tax credit on Airplane only if Airplane was predominantly used in a qualified business use, that is, more than 50 percent of Airplane's total use was qualified business use. Because Airplane was leased for a number of uses, such as business travel by employees of Retail and personal use by Owner and members of Owner's family, we must determine which of these uses are and which of these uses are not qualified business use of Airplane.

A purpose of the qualified business use provisions, contained both in the Code and in the temporary regulations, is to place restrictions on the availability of accelerated depreciation and the investment tax credit on property that is susceptible to personal use. Section 280F(d)(6)(C)(i)(I) of the Code accomplishes this by excluding from qualified business use the leasing of property to any 5-percent owner or related person. Section 1.280F-6T(d)(2)(ii) of the temporary regulations clarifies this by specifying that the exclusion is applicable only to the extent that use of the property is by an individual who is a related party or 5-percent owner of the

owner or lessee of the property. That is, the limitation is on use by one who is capable of using the property for personal purposes.

In the present situation, Retail leases Airplane. But its employees are the ones who actually use Airplane in the operations of Retail and are capable of personal use of Airplane. It is this personal use to which the Code and temporary regulations are aimed. Thus the use of Airplane by these employees and their relationship to the 5-percent owner (Owner), owner (Taxpayer), or lessee (Retail) are what is important in ascertaining whether the use through lease of Airplane to Retail is qualified business use.

We must evaluate each use of Airplane to determine that amount of its use that is qualified business use. For an aircraft, section 1.280F-6T(d)(2)(ii)(B) of the temporary regulations provides a special rule for computing qualified business use. That rule is that if at least 25 percent of the total use of the aircraft consists of business use other than uses described in section 1.280F-6T(d)(2)(ii)(A), including leasing or compensation for services to any 5-percent owner or related person,¹ then the use in connection with such leasing and compensation for services is added to the other business use to determine total qualified business use of the aircraft. However, if less than 25 percent of total use of the aircraft consists of business use other than the uses described in section 1.280F-6T(d)(2)(ii)(A), then the use in connection with leasing or compensation for services to any 5-percent owner or related person is not added to business use to determine total qualified business use of the aircraft.

Because Owner is 5-percent owner of Taxpayer, all members of Owner's family are related persons for section 280F(d)(6)(C)(i) of the Code and are individuals within the meaning of section 1.280F-6T(d)(2)(ii)(A) of the temporary regulations. See section 267(b)(1) and 267(c)(4). Therefore, the use of Airplane by these related individuals, whether for personal purposes or for operations of Retail, is not business use for the 25-percent-qualifying-business-use test.

Under the facts provided to us, the individual employees of Retail other than Owner's son are not members of Owner's family. Whether those employees of Retail are related parties is a separate issue for purposes of the 25-percent-qualifying-business-use test. Section 267(b)(2) and (11) of the Code treats an individual and an S corporation as related persons only in those circumstances where the individual owns more than 50 percent of the stock of an S corporation. Even though each of the two S corporations, Taxpayer and Retail, are related

persons to one another, in the absence of significant ownership of stock or ownership in the taxable entities, the employees of Retail other than Owner's son could not be those individuals who are related parties or 5-percent owners with respect to the owner or lessee of the property.

Thus, the use of Airplane by Retail's employees other than Owner's son is not one of the uses disallowed by section 280F(d)(6)(C)(i) of the Code and section 1.280F-6T(d)(2)(ii) of the temporary regulations. Retail's employees other than Owner's son may be capable of using Airplane for personal purposes, but they are not related parties. Therefore, we must conclude that any use of Airplane by Retail's employees other than Owner's son was not use by related parties. This use of Airplane (even without considering other uses) satisfied the requirements of the 25-percent-qualifying-business-use test. ²

Because use of Airplane satisfied the requirements of the 25-percent-qualifying-business-use test, the special rule for aircraft in section 1.280F-6T(d)(2)(ii)(B) of the temporary regulations permitted leasing to any 5-percent owner and a related person to be business use of Airplane. Thus, the use described in section 280F(d)(6)(C)(i) of the Code in the trade or business of Taxpayer could be added to the business use of Retail's employees other than Owner's son in determining whether Airplane was predominantly used in qualified business use under section 280F(b)(4).

Whether standby time must be accounted for in the computation of business/investment use was another question raised in the request for technical advice. Sections 1.274-5T(b)(6)(B) and 1.280F-6T(e)(2) of the temporary regulations require the amount of each business/investment use for any means of transportation to be substantiated in mileage. Therefore, standby time is not material in determining the qualified business use of Airplane.

CONCLUSIONS

Airplane was not excepted from being an item of listed property during tax years *
* * Airplane was neither leased by a person regularly engaged in the business of leasing for purposes of section 280F(c)(1) of the Code nor was it substantially used for providing transportation services to unrelated persons.

During the years at issue, use of Airplane by Retail's employees who were not "related parties or 5-percent owners" constituted qualified business use by Taxpayer. Because that use of Airplane was at least 25 percent of the total use in

each of those tax years, the special rule for aircraft in section 280F(d)(6)(C)(ii) of the Code allowed the use of leased Airplane by any 5-percent owner or related person during those years also to be qualified business use. The total of this qualified business use of Airplane exceeded 50 percent of total use during each year at issue.

The conclusions in this technical advice memorandum do not address any taxable income liability accruing from a fringe benefit or compensation for services.

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

FOOTNOTES

¹ Uses specified in section 280F(d)(6)(C)(i) of the Code and section 1.280F-6T(d)(2)(ii)(A) of the temporary regulations are uses generally not included in qualified business use.

² Use by employees of Retail other than Owner's son accounted for more than 50 percent of the total use of Airplane.