IRS Chief Counsel Advisory 201601011 (2015)
Aircraft Held for Productive Use

IRS Chief Counsel Advisory ("CCA") 201601011, issued on December 31, 2015, concerned the following fact situation:

> Partnership O is the principal entity in an affiliated group of businesses ("O group"). O uses private aircraft for business purposes and as perks for its executives. A and B are two of O's senior executives, and they indirectly own partnership interests in O. A and B are the principal users of O's aircraft, which they use for both business and pleasure. They are also the indirect, equal owners of Partnership P, an O affiliate. For business and legal reasons, these aircraft are owned by P. P owns no other operating assets, but it does own interests in O group affiliates.
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> When A and B use these aircraft for personal purposes, they report that use as income, but they do not otherwise pay for it. The CCA mentioned that the IRS field office did not challenge whether P is a legitimate partnership rather than a sham entity, and it noted that if Partnership P is a sham entity, that could change the relevant conclusions. Partnership P leases its aircraft to Partnership O under a "dry lease". That is, Partnership P provides the aircraft, only. O provides the flight crew and maintenance.
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> In Year 1, P exchanged old aircraft for new aircraft. Lease payments for the relinquished aircraft roughly reflected fair market value. Lease payments for the replacement aircraft are below market cost but still cover carrying costs. Lease payments for both the relinquished aircraft and the replacement aircraft were not designed to generate "meaningful economic profit" for P.
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> The IRS field office challenged whether P held the aircraft for "productive use in trade or business or for investment". In making its determination, the field office sought to apply the standards of *IRC § 183*. That section of the tax code applies to individuals and to S corps. It distinguishes deductible business expenses (generally, expenses for activities engaged in for profit, whether or not profits are being earned) from nondeductible expenses (generally, other expenses that cannot be deducted except to the extent that actual profits from those activities are earned).

On these facts, the CCA observed and concluded:

> There is no authority for using *IRC § 183* as a standard to determine if property is held for productive purposes in the context of *IRC § 1031*. The CCA rejected that standard. Rather, companies often hold property for productive use which, if viewed as a separate activity, would not generate profit. Both the field office and the CCA agreed that the personal use of the aircraft by A and B was *not relevant* in determining whether P held the aircraft for productive use. [This appears to this writer to be based on the fact that providing perks to O's executives is a legitimate business purpose of O, despite the fact that those executives are the effective owners of the aircraft. There may be an implicit assumption that use of the aircraft as perks for A and B's personal use is not the principal purpose of the aircraft. However, based on the rationale of the CCA stated below, that distinction may not be critical.]
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> For any number of business and legal reasons, businesses often own property, especially aircraft, in separate entities. If O, a legitimate business, owned the aircraft directly or through a wholly owned subsidiary, there would be no question that the aircraft are held for productive use. Both business

travel and use of the aircraft as perks for O's executives appear (from the CCA analysis) to qualify as productive use by O. The fact that this equipment was held in the name of an affiliated entity that is not wholly owned by O and is leased to O at below market prices does not change that result.

However, the below market rent and ownership of the aircraft by A and B may be significant considerations for the application of other tax provisions such as *IRC § 280F* (which deals with the depreciation and treatment of leases for luxury automobiles, aircraft and other items used for both business and non-business purposes) and *IRC § 482* (which allows the IRS to reallocate income, deductions and other tax items among affiliated entities when necessary to avoid tax evasion or to more accurately reflect the actual income of each entity).