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Washington, DC 20224

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Refer Reply To:
CC:PSI:B06
PLR-105634-04
Date:
September 30, 2004

RE: Original use for purposes of the additional first year depreciation deduction

LEGEND:
Taxpayer =
Aircraft =
Aircraft2 =
A =

B =
C =
D =
E =
F =
G =
H =
I =
J =
K =
L =
M =
N =
O =
P =
Q =
R =
S =
Date1 =
Date2 =
Date3 =
Date4 =
Date5 =

SB/SE =
Official

Dear :

This letter responds to a letter dated January 23, 2004, and supplemental correspondence, requesting a ruling that the original use of Taxpayer's Aircraft commenced with Taxpayer for purposes of the 50-percent additional first year depreciation deduction provided by section 168(k)(4) of the Internal Revenue Code.

FACTS

Taxpayer represents that the facts are as follows:

Taxpayer, a P general partnership, is engaged in the insurance services business through various subsidiaries. For federal income tax purposes, Taxpayer has elected to be treated as an association, taxable as a corporation.

Taxpayer owns all of the membership interests in Q, a P limited liability company. Q is a disregarded entity under section 301.7701-3(b)(1)(ii) of the Procedure and Administration Regulations and is treated as a division of Taxpayer.

Taxpayer and Q own all of the interests in B, a P limited partnership. Taxpayer is the limited partner and Q is the general partner. Because Q is a disregarded entity, B is also a disregarded entity and all of its assets and liabilities are treated as owned by Taxpayer for federal income tax purposes.

B owns all of the membership interests in A, a P limited liability company. Accordingly, A is also a disregarded entity and all of its assets and liabilities are treated as owned by B for federal income tax purposes. A is a certificated air carrier engaged in the air charter business.

In Date 2, C, a foreign company, and D, a manufacturer of aircraft, entered into a purchase agreement under which C agreed to purchase the Aircraft from D. As of the date of the purchase agreement, there were E hours on the Aircraft. Later in Date 2, C accepted the Aircraft, with R hours on the Aircraft. Also in Date 2, C and D entered into an agreement for D to perform certain modifications to the Aircraft.

While C accepted the Aircraft, C never took physical delivery or possession of the Aircraft. Subsequent to the date of the purchase agreement, the Aircraft was flown by D pilots to D's service facility for completion of the modifications agreed upon. Proving flights were made by D pilots for quality assurance testing of the modifications and return of the Aircraft to S, bringing the total flight time to F hours. Following the completion of the modifications, the Aircraft was placed into storage in D's hangar.

On Date3, C formally acknowledged completion of the modifications to the Aircraft. Also on Date3, C entered into an agreement to purchase the Aircraft2 from D, pursuant to which C traded in the Aircraft for the Aircraft2, without ever taking physical

delivery of the Aircraft. D received the Aircraft, with G hours, on a trade-in by C for the Aircraft2 on Date4.

Upon reacquisition of the Aircraft, Taxpayer and D represent that D continued to hold the Aircraft primarily for sale. In addition, Taxpayer and D represent that D temporarily used the Aircraft as follows: (a) as a demonstrator; (b) for transportation of D officials on D business; (c) to ferry the Aircraft to an airport other than H for a static showing of the Aircraft; (d) to ferry the aircraft to a service center; (e) to ferry home or reposition the location of the Aircraft, in connection with one of the above uses of the Aircraft; and (f) in two instances, the Aircraft was loaned to customers under no cost leases, each for a period of one month or less, for use by the customer pending delivery of an aircraft that had been ordered by the customer. Taxpayer and D represent that at all times, D continued to show the Aircraft and to hold the Aircraft primarily for sale.

A purchased the Aircraft from D on Date1, which is after May 5, 2003. No binding contract for the purchase of the Aircraft by A was in effect prior to May 6, 2003. D represents that the total flight time on the Aircraft from Date4 until date of sale of the Aircraft to A with delivery on Date5, the day after Date1, was approximately I flight hours of which: (1) the uses listed in the above previous paragraph (a) through (d) comprised approximately J hours; (2) the use listed in the above previous paragraph (e) comprised approximately K hours; and (3) the use listed in the above previous paragraph (f) comprised approximately L hours. The total flight time on the Aircraft upon delivery to A on Date5 was M hours.

D represents that the Aircraft typically has an average annual usage of N flight hours and is expected to have an actual useful life in excess of O years. D also represents that neither D nor any related taxpayer has claimed depreciation with respect to the Aircraft for federal income tax purposes.

Upon purchase of the Aircraft, on Date1, A has used the Aircraft for lease to other entities pending certification of the Aircraft for air charter services.

RULING REQUESTED

The original use of the Aircraft, for purposes of the 50-percent additional first year depreciation under section 168(k)(4), commenced with Taxpayer.

LAW AND ANALYSIS

Section 168(k)(4) provides a 50-percent additional first year depreciation deduction for the taxable year in which 50-percent bonus depreciation property is placed in service by a taxpayer.

Section 168(k)(4)(B) defines the term “50-percent bonus depreciation property” as meaning property (i) among other things, to which section 168 applies with a

recovery period of 20 years or less, (ii) the original use of which commences with the taxpayer after May 5, 2003, (iii) that is acquired by the taxpayer after May 5, 2003, and before January 1, 2005, but only if no written binding contract for the acquisition was in effect before May 6, 2003, and (iv) that is placed in service by the taxpayer before January 1, 2005, or for certain property having longer production periods, before January 1, 2006.

Section 1.168(k)-1T(b)(3)(i) of the temporary Income Tax Regulations provides, in part, that, except as provided in sections 1.168(k)-1T(b)(3)(iii) and (iv), original use means the first use to which the property is put, whether or not that use corresponds to the use of the property by the taxpayer.

It is intended that, when evaluating whether property qualifies as "original use" property, the factors used to determine whether property qualified as "new section 38 property" for purposes of the investment tax credit would apply. Joint Committee on Taxation Staff, General Explanation of Tax Legislation Enacted in the 107th Congress, January 24, 2003, footnote 208. In order to qualify as "new section 38 property" for investment tax credit purposes, section 1.48-2 required that the original use of the property commences with the taxpayer.

This original use requirement has been a factor for determining "new section 38 property" for the investment tax credit since section 48 was enacted by the Revenue Act of 1962. Both the House and Senate committee reports on the Revenue Act of 1962 stated that the principles applicable under section 167(c) are to be applied under section 48(b) in determining whether the original use of the property commences with the taxpayer. H. R. Rep. No. 1447, 87th Cong., 2d Sess., 1962-3 C.B. 402, 519; S. Rep. No. 1881, 87th Cong., 2d Sess., 1962-3 C.B. 703, 862. Both the House and Senate committee reports on H.R. 8300, which enacted section 167(c), discussed original use as relating to property that "must be new in use, that is, never before having been subject to depreciation whether or not depreciation deductions relating to such property were allowable." H. R. Rep. No. 1337, 83d Cong., 2d Sess. A49 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 203 (1954).

Rev. Rul. 69-272, 1969-1 C.B. 23, concludes that although the airplanes are used as demonstrators, the airplanes are stock-in-trade held primarily for sale to customers in the ordinary course of business and, consequently, the use of such airplanes as demonstrators does not constitute a "use" for investment credit purposes. Accordingly, the airplanes are "new section 38 property" in the hands of the purchaser.

Consistent with Rev. Rul. 69-272, Example 2 of section 1.168(k)-1T(b)(3)(v) illustrates that if an automobile that is used as a demonstrator by an automobile dealer is held by the dealer primarily for sale to customers in the ordinary course of its business, the use of the automobile by the dealer as a demonstrator does not constitute a "use" for purposes of the original use requirement for the additional first year

depreciation deduction and, thus, the first purchaser of the automobile would be considered the original user of the automobile.

While C accepted delivery of the Aircraft, C never took physical delivery or possession of the Aircraft. Consequently, C never used the Aircraft and, therefore, is not considered the original user of the Aircraft for purposes of the original use requirement in section 1.168(k)-1T(b)(3)(i).

Consistent with Example 2 of section 1.168(k)-1T(b)(3)(v), D's use of the Aircraft as a demonstrator after its acquisition from C is not a "use" for purposes of the original use requirement in section 1.168(k)-1T(b)(3)(i).

However, D's other uses of the Aircraft after its acquisition from C goes beyond the facts of Example 2 of section 1.168(k)-1T(b)(3)(v) and Rev. Rul. 69-272. The question of whether the Aircraft was held for use in D's trade or business or was held by D primarily for sale to customers in the ordinary course of business is a question of fact. If property is acquired for resale and is temporarily used by a taxpayer in its business, the property would properly remain as inventory because the use of property temporarily in a business does not support re-characterizing the property as property used in a trade or business. See e.g., Duval Motor Co. v. Commissioner, 264 F.2d 548 (5th Cir. 1959), aff'g, 28 T.C. 42 (1957) (automobiles removed from inventory by car dealer and provided to company officials and salesmen to stimulate interest in cars were only temporarily assigned for use in car dealer's business).

In the present case, Taxpayer and D represent that at all times, D held the Aircraft primarily for sale even when the Aircraft was used by D for the various uses listed in the second paragraph on page 3 of this letter ruling. Further, D represents that the Aircraft typically has an average annual usage of N flight hours and is expected to have an actual useful life in excess of O years. Consequently, D's various uses of the Aircraft, which totaled I flight hours, account, in the aggregate, for less than two percent of the Aircraft's estimated flight time over the Aircraft's useful life. Accordingly, we conclude that the various uses of the Aircraft by D can reasonably be characterized as temporary.

CONCLUSIONS

Based solely on the representations and the relevant law and analysis set forth above, we conclude that: (1) the original use of the Aircraft commences with A for purposes of the 50-percent additional first year depreciation under section 168(k)(4); and (2) because A is a disregarded entity and the Aircraft is treated as owned by Taxpayer, Taxpayer will be considered the original user of the Aircraft for purposes of the 50-percent additional first year depreciation under section 168(k)(4).

Except as specifically ruled upon above, no opinion is expressed or implied concerning the tax consequences of the facts described above. Specifically, no opinion

is expressed or implied on whether the Aircraft meets all of the requirements to be eligible for the 50-percent additional first year depreciation deduction.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney, we are sending a copy of this letter to Taxpayer. We are also sending a copy of this letter to the SB/SE Official.

Sincerely,

KATHLEEN REED

Kathleen Reed
Senior Technician Reviewer, Branch 6
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
6110 copy
copy of this letter