News from the Hill

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Congressional Bill Provides Tax Benefits for AEA Members

The House has passed a tax bill that it is interesting for two reasons. First, it creates a remedy to a problem that threatened to cut off much trade between the United States and Europe. Second, it provides tax benefits that many AEAmembers will benefit from. For those of you with no interest in history, please skip the Where Did This Bill Come From? section and go directly to the description of the actual tax benefits below.

In order for a bill to become a law, it must be passed in identical forms by both the House and the Senate before being sent to the President for signature. Although the Senate has already passed a similar bill, the Senate language differs in many significant ways from the house language so the House and Senate will soon be 'conferencing' the distinctions in the language. The Senate language does not include all of the tax benefits found in the House version. Although representatives from both the House and Senate are 'hopeful' that the Conference Committee can complete its work by August, it is possible that the Conference Committee's work will not be complete until after Labor Day.

The proposed provisions most likely to affect AEA members (other than our manufacturer members, who are likely to see a wide variety of tax changes as a consequence of this bill), are the extension of increased expensing, which works to the advantage of both AEA members and their customers, and the tax incentive for the purchase of corporate aircraft, which should help motivate some of our customers to purchase new aircraft, and will save them enough in taxes to prompt them to invest in the best avionics suites that money can buy!

AEA members with high revenues and low profit margins may find that the alternative minimum tax [AMT] can treat them unfairly in years where they have significant deductions. The proposed bill also includes AMT relief for companies with average revenues of $20 million or less.

Where Did This Bill Come From?

Those of you who followed the saga know that for several years, the United States and Europe have been teetering on the edge of a trade war that could wreak havoc on the U.S. aviation industry by imposing punitive tariffs on certain items imported into Europe from the United States. The United States has supported certain U.S. exports with a tax incentive known as the Foreign Sales Corporation/ExtraTerritorial Income (FSC-ETI) provisions.

U.S. trading partners, particularly those in the European Union (EU), claimed that the FSC/ETI export incentive amounted to an illegal trade subsidy in violation of the General Agreement on Tariffs and Trades (GATT). In 2002, the World Trade Organization (WTO) ruled the FSC/ETI export incentive regime is illegal, and authorized the EU to impose retaliatory tariffs on U.S. goods falling into certain categories. One of those categories was aviation and aerospace parts and products, so this was a serious concern for our industry.

The authorized tariffs were estimated at about $4 billion per year. The EU agreed not to impose these sanctions as long as the United States changed the FSC/ETI export incentive law so that it no longer violated GATT. This put pressure on the United States Congress to respond to the WTO ruling and prevent retaliatory trade sanctions from the EU by amending U.S. tax law to comply with GATT.

While Congress was working on corrective legislation, the United States also engaged in negotiations with the EU to limit the effect of any tariffs that might be imposed. On December 8, 2003, the EU issued Council Regulation No. 2193/2003 (December 8, 2003), which established customs duties on imports of certain products originating from the United States. This Council Regulation represented a victory for the aviation industry as well as for U.S. diplomacy, because aviation industry products were excluded from the final list of products targeted

for sanctions. In particular, despite the long list of electronics subject to the sanctions, avionics products were excluded from the sanctions list.

What is the General Purpose of the Bill?

The U.S. House of Representatives approved H.R. 4520, the American Jobs Creation Act, on June 17. The primary purpose of this bill is to amend certain sections of the U.S. Internal Revenue Code that are seen as unfair for purposes of international trade (eliminating the FSC-ETI)—by doing this, the bill will end certain EU trade sanctions being levied against U.S. exporters. In addition, the bill creates tax benefits for American businesses in order to promote job growth.

The legislation repeals the foreign FSC-ETI provisions of the U.S. Internal Revenue Code. The FSC-ETI had provided tax benefits for U.S. exporters. The World Trade Organization (WTO) had previously warned that the FSC-ETI was inconsistent with the United State's trade obligations; however, the United States did not change its policy because it did not believe that other countries would retaliate. The EU responded to the FSC-ETI by petitioning the WTO for permission to impose sanctions, and by passing legislation in December 2003 that imposed retaliatory sanctions against U.S. exporters, effective March 2004.

The sanctions affected exported products such as iron, steel and electrical machinery, equipment and parts. They amounted to a 5 percent tariff on goods in March of 2004, with the tariff increasing by 1 percent per month until the FSC-ETI is repealed (so the August tariff is 10 percent). The American Jobs Creation Act will repeal the FSC-ETI, thus ending the tariffs on American manufacturers. The bill provides $13 billion of FSC-ETI transition relief over three years, and reduces the top corporate tax rate from 35 to 32 percent for domestic manufacturers and small corporations to compensate for lost benefits under FSC-ETI.

What Was That? Reduced taxes?

That's right! The bill reduces the top corporate tax rate that most AEA member swill pay to just 32percent. That is reduction from the top rate of 34 percent seen by many AEAcorporations. Here is a table that illustrates how the tax laws would change:

Current Corporate Tax Categories	Current Corporate Tax Percenta ges	Proposed Corporate Tax Categories	Proposed Corporate Tax Percenta ges
< $50,000	15	< $50,000	15
$50,000-$75,000	25	$50,000-$75,000	25
$75,000-$10,000,000	34	$75,000-$20,000,000	32
> $10,000,000	35	> $20,000,000	35

The new corporate tax rates would apply as of 2013. They would be phased in gradually through a staged decrease in corporate tax rates between tax years 2005 and 2013.

This would benefit AEA members that are organized as 'C' corporations and that either retain revenues in the corporation or that distribute dividends to owners of the corporation (either of these events triggers taxation at the corporate level). The benefit would only be recognized where the company is taxed on more than $75,000 in income. Remember, deductible corporate expenses like salaries, expenses, etc. all will usually reduce the corporation's total tax liability.

Tax rate relief, and the other small business tax provisions in this bill, are all designed to promote the growth of small business because Congress has recognized that small businesses are the No. 1 providers of new jobs. The rate relief is not included in the Senate bill, so this is an issue that could be subject to compromise.

Extended Expensing Limits

Many AEA member (and their customers) have taken advantage of the increased expensing limits, which allow up to $102,000 of depreciable equipment to be expensed (meaning that it can be deducted in the same tax year it was purchased, and does not have to be depreciated over time). In tax year 2006, this limit is scheduled to be returned to the 'normal' limit of $25,000. This tax benefit is only available to taxpayers who are considered 'small businesses' under Small Business Administration rules.

The House bill would extend the increased expensing limits by two years, so that AEA members and their customers could enjoy these benefits through the 2007 tax year (the limit would return to $25,000 in tax year 2008 under this proposal).

Without this provision, an AEA member who buys test equipment and other depreciable assets valued at $100,000 would have to depreciate the equipment over a period of years (usually five years). This would mean that the company's first year tax deduction for the depreciation for this equipment would likely be $20,000. The basic $25,000 expensing provision allows a

Continued on following page

NEWS FROM THE HILL
Continued from page 27

first year deduction of $40,000 ($25,000 plus 20 percent of the $75,000 remainder), accelerating the tax benefits associated with the purchase. Under the increased expensing provision, an AEA member who buys test equipment and other depreciable assets valued at $100,000 gets to depreciate the entire amount in the first year! This maximizes the potential benefit for a $100,000 investment!

Corporate operators, air taxi services, agricultural operator or anyone else who uses their aircraft for business purposes may be able to use the increased expensing provisions to maximize the tax benefits associated with the avionics upgrades they have purchased from AEA members.

The Senate version of the bill does not include this House provision, but it does include a clause that makes section 179 expensing available to companies who spend up to $614,000 a year in assets (the current cap is $512,000).

Incentives to Purchase Corporate Aircraft

Current law includes certain tax incentives for purchasing 'transportation property' which includes aircraft used "in the trade or business of transporting persons or property." Business purchasers of aircraft enjoy a 50 percent bonus depreciation. This means that the business purchaser is allowed to deduct 50 percent of the purchase price in the same tax year as the purchase, plus the purchaser can also deduct the normal depreciation associated with the remaining value of the aircraft.

The proposed House Bill would extend these tax advantages to GAaircraft that are not considered 'transportation property,' as well (as long as they are purchased for business purposes). This would extend the application to aircraft like corporate jets, which are not considered 'transportation property' but which are used for business purposes. The tax advantages would be extended to all aircraft except those that are used for agricultural or firefighting purposes (and even these can take advantage of the aircraft tax provisions if they also qualify as not considered "transportation property").

If you know a corporate aviation department considering the purchase of a new aircraft, make sure that your customer tracks this legislation closely, as it is likely to create a two-year window of tax advantages for purchasers of corporate aircraft (tax years 2004 and 2005).

Here are some details on this aircraft purchase tax benefit. The aircraft must be purchased (this tax provision does not apply to leases). At the time of the contract for purchase, the purchaser must make a nonrefundable deposit of the lesser of 10 percent of the cost of the aircraft or $100,000. The aircraft must cost at least $200,000. The aircraft cannot be a unique or limited production aircraft—the way that the tax law addresses this concern is to limit its use to aircraft that have "an estimated production period exceeding four months."

This provision is in the Senate version, so it is likely to be included in the final bill.

Alternative Minimum Tax for Small Corporations

Many corporations actively try to structure their income and deductions to avoid the alternative minimum tax [AMT]. This can be especially difficult for smaller businesses experiencing unusual business conditions. Congress has recognized that slim profit margins can mean that a small business should not be subject to the AMT, and has increased the AMT exemption to permit more small businesses to avoid the corporate AMT.

Current law provides a break from the AMT for small corporations. Any company that has average annual gross receipts of $7.5 million or less for the past three taxable-year periods is exempt from the corporate AMT. Because some AEA members experience high costs of doing business, their revenues may be quite high (substantially higher than their profits due to a slim profit margin). Thus, you do not have to be a Fortune 500 company to have revenues exceeding $7.5 million. The proposed House bill would increase this AMT exemption to average annual gross receipts of $20 million or less.

The Senate version of this legislation does not include this clause, so it will be subject to the negotiations of the Conference Committee.

Conclusion

The House Bill contains a number of measures that could benefit AEA members, but not all of them are in the Senate version of the bill. The Bush Administration has indicated that repealing FSC-ETI is a priority, so it is clear that some sort of tax bill will be completed, and that it is likely to be completed on a fast track. If you feel that some of these clauses would benefit your business, then you should contact your Senators to ask them to support the House version of the bill—H.R. 4520—when it comes to the Senate for passage.

The figure found in the U.S. Code says $100,000, but this limit has been increased to $102,000 for tax year 2004 by 2003-49 Internal Revenue Bulletin 1184 section 3.17 (December 8, 2003). ❑