AIN BUSINESS JET TRAVELER

More Money

It doesn't have to cost a fortune

By Jeff Wieand - October 2010

ELSEWHERE IN THIS ISSUE, YOU'LL FIND PLENTY of discussion about the tangible and intangible benefits of using business aviation, but what about the expenses? Nobody ever said flying privately is cheap, but the good news is that it can be less costly than you might think–if you take steps to minimize expenses.

One reason business aviation is often unduly expensive is that people buy the wrong airplane. But the first mistake is often buying an aircraft at all. The average business jet flies about 400 hours per year, according to statistics compiled by the National Business Aviation Association. If you fly only 100 hours per year, don't expect owning your own jet to be cost-effective. At this level of usage, it's worth considering such alternatives as charter and fractional programs.

Charter is generally the least expensive form of business jet travel, especially if you have lots of round-trip flights in compressed time periods from major cities. For example, if a typical trip is from Teterboro, N.J., to Los Angeles on Monday, returning Tuesday, you'll be hard-pressed to find a cheaper private-aviation alternative than chartering a Teterboro-based heavy jet. But if a typical trip is Iuka to Altoona, Pa., on Monday, returning two weeks later, a fractional program (which doesn't charge extra for positioning) may easily be the least expensive option.

If you don't fly enough hours to justify owning a jet, you might consider acquiring an airplane with one or more partners. In some ways, this is like forming your own little fractional ownership program–and it comes with many of the same headaches. Probably the biggest point of contention is figuring out who gets to use the aircraft when and how to align ownership costs fairly with usage costs. Joint-ownership arrangements often come to naught because one "equal" partner ends up using the aircraft a disproportionate amount. Such arrangements can doom the best of friendships.

If purchasing an aircraft, either alone or with others, is right for you, the next key decisions you have to make concern what model and aircraft to buy. Opportunities to overspend abound here. Just as you wouldn't be wise to buy a Ferrari if your typical drive is to the grocery store, so it doesn't make sense to purchase a Gulfstream G550 if your typical trip is flying two passengers from Detroit to Chicago and back. My favorite example of making this kind of mistake concerns a guy who put a Falcon 50 on the market two months after he bought it because he found out it couldn't take him where he needed to go nonstop.

You can still save money even after you have identified the right model or models for your missions. On an apples-to-apples basis, aircraft of the same model for sale often represent value differences of many millions of dollars. Take it to the bank: you won't be able to assess the true values of aircraft in the marketplace without the help of an unbiased professional adviser.

ONCE YOU DECIDE ON AN AIRCRAFT TO purchase, the next step is deciding how to pay for it. Here again, your choice may have a big impact on how cost-effective it is to own the airplane.

For many businesses and high-net-worth individuals, financing makes sense because there are better uses for the buyer's capital than locking it up in an aircraft. If your typical return on investment is 10 percent, you'd be wise to borrow, say, the $8 million purchase price of a jet at 4 percent (in many cases a tax-deductible cost) and use your own money for a more suitable $8 million investment.

But not all loans are equal. One way to inflate your financing costs is to choose non-recourse. Being able to "walk away" from the aircraft and leave a bank "holding the bag" may sound attractive, but it's an expensive option few aircraft owners ever select, and it can significantly increase financing costs, both by requiring a larger down payment (30 to 40 percent isn't uncommon) and a higher interest rate.

Normal recourse financing is a much better financial deal. These days, interest spreads remain high, but actual interest rates are relatively low–at least compared with historic rates. (Unfortunately, returns on investment are often equally low.) If maximizing cash flow is your objective, however, you should consider lease financing, which may offer greater flexibility than simply borrowing from a bank. Whichever route you go, be sure to solicit, compare and negotiate several financing proposals to ensure that you get the best deal possible.

First-time aircraft buyers often turn to management companies to operate their airplanes. This introduces an additional expense: monthly management fees. But management companies can also save you money, generally through economies of scale–such as fuel discounts, fleet insurance policies, favorable hangar rent and so on.

Most management companies offer another cost-saving strategy: third-party charter. You shouldn't fall for claims that the aircraft can "pay for itself" if you charter it out, and charter may make no sense for you if you'll need the airplane a lot yourself. But if your own usage is limited and flexible, charter can provide an opportunity to offset some of the fixed costs of ownership. As the owner/operator, you're already on the hook for things like crew salaries, depreciation, opportunity cost, hangar and insurance, whether the aircraft flies or not. With outside charter, you can effectively transfer some of that expense to other business jet travelers.

Keep in mind, though, that charter is no golden-egg-laying goose. In fact, it can cost you money. Additional equipment may be required; additional flight hours cause the aircraft to depreciate more rapidly; additional pilots may be needed to handle the extra hours the aircraft will be flying for charter customers; and a less-attractive depreciation schedule may be necessary.

FINALLY, YOU CAN ACTUALLY GET UNCLE SAM to help pay for your aircraft. You can generally deduct for income tax purposes the expenses associated with owning and operating an airplane in a trade or business, and that can make ownership more feasible on an after-tax basis.

The biggest cash-flow booster is usually depreciation expense. As a rule, if more than 50 percent of the aircraft usage is in a trade or business, the airplane is eligible for accelerated tax depreciation (MACRS), which permits you to write off more than 50 percent of its basis in the first two years and the entire sum over six years (assuming 100 percent business use). Bonus depreciation, which Congress has served up with some regularity in recent years, makes the tax benefit even more enticing. But though IRS rules allow you to take depreciation on your aircraft in the tax world much faster than it actually depreciates in the real one, when you sell it, you will have taxable income (depreciation recapture) to the extent that the sale proceeds exceed your tax basis–unless you shield the income using a tax-free exchange. Thus, tax depreciation subject to recapture is best thought of as an interest-free loan from Uncle Sam.

Most other aircraft expenses aren't subject to recapture and thus deducting them for tax purposes represents a permanent economic benefit–assuming you have the income to offset. But unless you're a big company making lots of money that uses the aircraft exclusively in its business, maximizing tax benefits associated with an airplane requires careful planning. IRS regulations are a minefield–passive activity, hobby loss, at-risk and entertainment disallowance rules readily come to mind. So consulting a professional who can make your tax planning fit with FAA and state requirements is essential.

If you can't use tax deductions–because, for example, you aren't using the aircraft in a trade of business or your business isn't producing sufficient taxable income–consider leasing from a financial institution that will write off the airplane in its leasing business, passing on the savings to you in lower financing costs.