PROPERTY & CASUALTY

Leveraging Tax Insurance in the Aviation Industry

By, Yonatan Tammam

Tax insurance is a specialized risk management tool that provides financial protection against adverse tax outcomes. In the aviation industry, where the acquisition, operation and ownership of aircraft involve significant tax considerations, tax insurance can be particularly valuable. This white paper explores the application of tax insurance to address risks associated with disallowed depreciation and deductions for the business use of aircraft. It highlights the benefits, challenges and best practices for establishing tax insurance strategies within the aviation sector.

The Role of Tax Insurance in the Aviation Industry

The aviation industry is uniquely exposed to complex tax issues due to the high value of aircraft, their mobility across jurisdictions and the interplay of international and domestic tax laws. Tax insurance mitigates these risks by covering financial losses resulting from unfavorable tax authority rulings. Specific to aviation, tax insurance can:

Safeguard against disallowed depreciation:

Aircraft owners often rely on accelerated depreciation to optimize tax liabilities. Tax insurance helps ensure that unexpected disallowance of depreciation by tax authorities does not lead to significant financial setbacks.

Address business use deductions:

Companies operating aircraft for business purposes can face scrutiny over the allocation of personal versus business use. Tax insurance provides coverage if deductions claimed for business use are challenged.

Key Tax Risks in the Aviation Sector

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- **Depreciation deductions:** Aircraft are typically depreciated over a defined recovery period using methods such as Modified Accelerated Cost Recovery System (MACRS). Tax authorities may disallow these deductions if the aircraft's classification or use does not meet specific criteria.
- **Business use deductions:** Companies must substantiate the percentage of aircraft use allocated to business versus personal purposes. Inadequate documentation or improper allocation can lead to disallowed deductions.
- **State and local tax exposure:** Aircraft operating across multiple jurisdictions face potential exposure to state and local taxes, including use and property taxes.
- **Tax compliance Complexity:** International operations introduce further complexity due to the application of treaties, VAT and customs duties.

Benefits of Tax Insurance for the Aviation Industry

- **Financial certainty:** Protects against unexpected liabilities, preserving cash flow and financial stability.
- **Transaction facilitation:** Enhances the attractiveness of transactions involving aircraft by mitigating tax-related uncertainties.
- **Audit defense:** Provides resources and specialized skills to address tax authority challenges effectively
- **Compliance assurance:** Encourages robust documentation and adherence to tax regulations, reducing the likelihood of disputes.

Best Practices for Implementing Tax Insurance

- **Engage early:** Involve tax advisors and insurers during the initial planning stages of aircraft acquisition or operational structuring.
- **Maintain comprehensive records:** Ensure accurate documentation of aircraft use, maintenance logs and business purpose substantiation.
- **Seek specialized advice:** Obtain legal and tax opinions to support the validity of tax positions before seeking insurance coverage.
- **Customize policies:** Tailor coverage to the specific risks and operational needs of the business.
- **Monitor compliance:** Regularly review tax positions and operational practices to help ensure alignment with regulatory requirements.

Tax insurance is a strategic tool that can provide significant value to the aviation industry by mitigating risks associated with disallowed depreciation and deductions for business use of aircraft. By adopting best practices and engaging specialized advisors, businesses can leverage tax insurance to enhance financial stability, help to ensure compliance and support growth in a complex regulatory environment. As tax authorities continue to scrutinize aviation-related deductions, tax insurance offers a proactive approach to managing uncertainty and safeguarding financial outcomes.

About the Author

Yonatan Tammam JD, LLM

Executive Vice President Transactional Risk, Head of Tax Insurance

yonatan.tammam@bbrown.com

Yonatan Tammam serves as Brown & Brown's Executive Vice President for Private Equity, Family Office and M&A and leads the tax insurance initiative at Brown and Brown. Yonatan graduated from University of Maryland – College Park, received his Juris Doctor degree from Benjamin N. Cardozo School of Law and holds an LL.M. in taxation from New York University's School of Law. As a former transactional tax attorney Yoni leverages his technical tax knowledge and practice experience to achieve creative solutions for complex tax issues with the use of tax insurance for a wide range of customers.

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