Volume 20, Issue 6 • December 31, 2012

The UPDATE Report

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Jalux Americas, Inc.
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(Continued on page 3)

Required "Consent to Search" Could Result in Danger to Your Shipment

One of ASA members recently asked questions about the Consent to Screen letter, which is an obligation derived from TSA regulations.

TSA regulations require air carriers and freight forwarders to have security programs. The Consent to Screen letter authorizes an air carrier or freight forwarder to screen cargo as part of their TSA-required security program.

The member raised two sets of concerns about the unintended impact on aviation safety of these letters. First, a search of some aviation materials could result in damage that might affect the airworthiness of the part, and the shipper could be held responsible despite the fact that the freight forwarder had actually occasioned the damage. The second concern is whether a shipper can impose burdens on the freight forwarder (like a duty to warn that cargo has been subjected to search so we can warn our customer to inspect for damage) or whether the freight forwarder can impose burdens on a shipper (like freight forwarder language that seeks indemnification from the shipper or otherwise seeks to shift any legal burden or liability). Under the current law, there are no clear answers to respond to either of these issues.

From TSA's perspective, the form of the Consent to Screen letter appears to be a matter of commercial practice. They do not appear to have any specific

(Continued on page 3)

INSIDE THIS ISSUE:

ASA
AVIATION SUPPLIERS ASSOCIATION

MESSAGE FROM ASA'S PRESIDENT

THE UPDATE REPORT

is the newsletter of the Aviation Suppliers Association.

OUR COMMITMENT

ASA is committed to providing timely information to help members and other aviation professionals stay abreast of the changes within the aviation supplier industry.

The UPDATE Report is just one of the many benefits that ASA offers members. To learn more about our valuable educational programs, please contact ASA.

THE UPDATE REPORT STAFF

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Dear Colleagues,

It is tough to write a positive year end note with all the news coverage about the stalled talks about the fiscal cliff. By the time you read the newsletter all the fiscal cliff issues may be resolved, postponed or in play. The news out of Washington DC is frustrating to say the least except for the glimmer of hope called RG III and the Redskins.

ASA ended its 19th year with a membership hovering around 500 companies representing the international marketplace with 75 percent of the membership located in the United States, 12 percent in Europe and the fastest growth areas in Southeast Asia and Middle East. ASA members know the importance of quality systems and have stepped up to the call of the industry for strong distributor trading partners by committing themselves to quality. ASA-100 accreditation represents 260+ global locations with the FAA AC 00-56 Distributor Accreditation Database supporting 597 companies. ASA using the acronym ASACB is an ISO accredited registrar and is starting to audit to AS 9100 and AS 9120.

In 2013, ASA expects to have one of our busiest years in government affairs advocacy. In addition to working with the FAA and EASA, on the horizon there are new export, customs, hazmat, shipping and business issues.

ASA's success is linked to its members and the strength of your companies not only for financial success for also for long term success which means a strong respectable industry. On behalf of ASA's Team – Stephanie Brown, Jason Dickstein, Diane Leeds, Dawn Carberry, Arthur Schweitzer, Kelly Lyon, Richard Smith, Michelle Billoir, George Ringger and myself, we wish you a happy and healthy new year.

Michele Dickstein

LIST OF ADVERTISERS

(Continued from page 1)

instructions in the regulations for what must be included in the consent letter, only a requirement that consent (to the searches covered by the regulations) is required.

The regulations state that an aircraft operator "must refuse to transport any cargo if the shipper does not consent to a search or inspection of that cargo" in accordance with the security system established under the regulations. 49 C.F.R. § 1544.205(d); see also 49 C.F.R. § 1546.205(b); 49 C.F.R. § 1548.9(b). The regulations also provide that any certified cargo screening facility (this is the category in which many freight forwarders fall) must refuse to offer to another certified cargo screening facility or aircraft operator any cargo if the shipper does not consent to a search or inspection of that cargo. 49 C.F.R. § 1549.101(c).

The regulations do not specifically state what form the consent to screen must take. However, the Certified Cargo Screening Program records keeping provision does provide that "[e]ach certified cargo screening facility must maintain records demonstrating compliance with all statutes, regulations, directives, orders, and security programs that apply to operation as a certified cargo screening facility." 49 CFR 1549.105(a). Additionally, the Preamble to the Air Cargo Security Requirements Final Rule states that:

> "While TSA does not state in which manner the shipper's consent to search or inspect cargo be obtained, it does require that the consent be explicit and in writing. TSA allows aircraft operators, foreign air carriers, and IACs to manage the collection of consent to search in a manner consistent with individual operational needs."

71 Fed. Reg. 30477, 30486 (May 26, 2006) (emphasis added).

So the requirement for a written consent comes from the preamble to the rule (not from the actual regulations). Written consent is further implied (but not required) by TSA regulations that require the freight forwarder to retain records (thus implying that such records must be in a format that may be retained).

Any recordkeeping requirement that the government wants to enforce has to be first approved by OMB. The OMB approval referenced in the TSA rule was limited only to creation of security programs and imposed no burden on shippers. This means that TSA may be precluded from bringing an enforcement action against a shipper for non-compliance with the recordkeeping requirement; but this does not stop a freight forwarder from refusing to do business with a shipper who does not complete the consent form that the freight forwarder insists upon.

(Continued on page 4)

(Continued from page 1)

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FOR THEIR REACCREDITATION TO THE ASA-100 STANDARD

(Continued from page 3)

In the preamble to the rule that established the obligation for the consent letters, TSA notes that "[t]he regulations allow a shipper to provide a blanket authorization, as proposed by IBM." IBM's proposal was simply "We suggest that the best alternative would be to permit the shipper to give a blanket authorization to the IAC as part of their contract or other supporting document or instruction to the IAC." ['IAC' is an Indirect Air Carrier] This TSA response sheds little light on the question of whether the freight forwarder or the shipper can impose commercial obligations on the other party through the blanket consent.

There is a very real danger of damage to the parts as a consequence of a search by TSA or by the freight forwarder. For example, avionics and other electronic equipment can be very sensitive to electro-static discharge. Most distributors of ESD-sensitive equipment have special workstations and infrastructure designed to protect ESD-sensitive equipment from ESD-related damage. It is likely that a freight forwarder lacks this ESD-protection infrastructure. Thus, a freight forwarder performing a search could damage ESD-sensitive equipment (and might not even know it).

This raises a strong argument in favor of the proposition that distributors should be able to seek notification when TSA or a freight forwarder performs an inspection of freight. Such notification would afford the shipper an opportunity to ask the receiving party to confirm that the inspection has not resulted in damage that could adversely affect airworthiness. But at present there is no means to obtain such notification short of making it a part of the contract with the freight forwarder.

Unfortunately, some freight forwarders actually include, as part of their standard consent to search form, a commitment from the shipper to indemnify and hold harmless the freight forwarder from damages, including in situations where the freight forwarder itself damages the shipment during the inspection. In some cases, these clauses may be unenforceable if there is no additional value provided in exchange for this indemnification, but in many cases the freight forwarders primary duties may serve as consideration to support enforcement of the indemnification clause.

Distributors should be vigilant about such clauses and should consider whether they should reasonably be part of the consent to search form that the distributor provides to the freight forwarder.

US Proposes "Accelerated Payments" for Small Businesses in Government Contracts

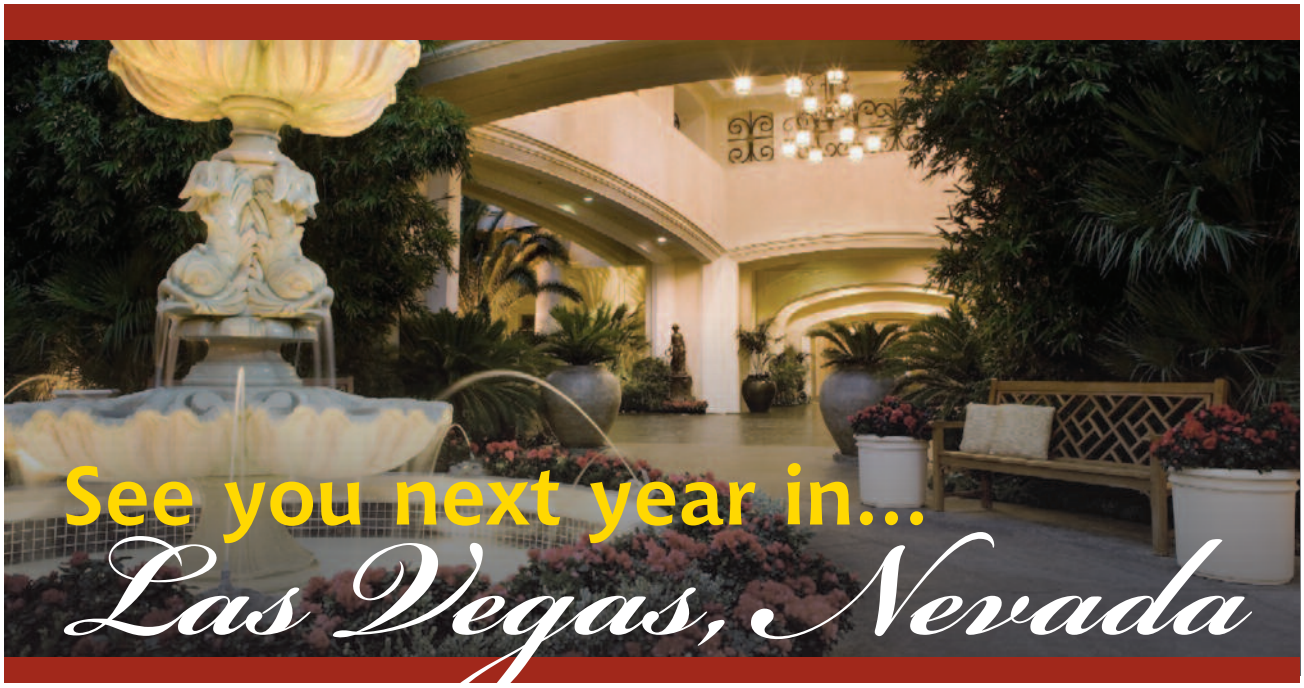
Did you know that under current law, a prime contractor might get an accelerated payment from the government, but be under no obligation to similarly accelerate payments to its small business subcontractors?

On July 11, 2012, the White House Office of Management and Budget issued Policy Memorandum M-12-16. The memorandum directed agencies to temporarily accelerate payments to all prime contractors, in order to allow them to provide prompt payments to their small business subcontractors. This is a temporary one-year policy.

While the policy memo is in effect, agencies are required to encourage prime contractors to pay small business subcontractors on an accelerated timetable to the maximum extent practicable. The government has developed a three-pronged approach to implement the policy:

1. For existing contracts, contracting officers are asked to communicate the policy to contractors and encourage their voluntary cooperation and participation. All prime contractors will receive accelerated payment from the Government and are encouraged to, in turn, pay their small business subcontractors on an accelerated basis. But there is no obligation to do so under this prong.
2. For current solicitations and future contracts, the FAR Council developed a contract clause that would require prime contractors to pay small business subcontractors on an accelerated timetable to the maximum extent practicable. Such a clause would make the payment of subcontractors on an accelerated basis a contractual obligation.

(Continued on page 6)



ASA 2013 Annual Conference

***** NEW SCHEDULE *****

Four Seasons Hotel • Tuesday–Thursday • July 9-11, 2013

(Continued from page 5)

3. A government team was assigned to analyze and make recommendations for Federal Acquisition Regulation changes aimed at improving payments by primes to small business subcontractors.

The result of this last prong, the recommendations for Federal Acquisition Regulation changes, is now apparent. The Department of Defense (DoD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA) have jointly published a proposed rule that would require federal contracts to include a clause that expressly requires prime contractors to accelerate payment to their small business subcontractors when the payment to the prime contractor is accelerated.

The proposed language for federal contracts looks like this:

Providing Accelerated Payments to Small Business Subcontractors

(a) Upon receipt of accelerated payments from the Government, the Contractor shall make accelerated payments to a small business subcontractor, to the maximum extent practicable and prior to when such payment is otherwise required under the applicable contract or subcontract, after receipt of a proper invoice and all other required documentation from the small business subcontractor.

(b) The acceleration of payments under this clause does not provide any new rights under the Prompt Payment Act.

(c) Include the substance of this clause, including this paragraph (c), in all subcontracts with small business concerns, including subcontracts with small business concerns for the acquisition of commercial items.

This seems like a positive measure for industry; however, one concern would be that the terms used in this clause are not well defined, and therefore a prime contractor who does not change their internal system to accelerate payments may claim that it is not practicable to accelerate payments. In such a case, the prime would get the benefit of accelerated payment but might not pass-along the full value of the acceleration to the small business subcontractors. With this in mind, it might make sense to improve this language to provide firmer metrics for compliance.

ASA members with comments or concerns should contact the Association to register their comments, so we can know your concerns, and should also file comments with the government in accordance with the directions found at 77 Federal Register 75089 (December 19, 2012). Please let us know whether you feel this clause may be important enough to your business to warrant ASA comments to the docket.

IRS Tax Treatment of Rotable Parts

Last December, the IRS announced new regulations concerning the distinctions between expenses and capital expenditures related to improvements to articles, like overhauls of rotable aircraft parts. The title of the rulemaking was "Temporary Guidance Regarding Deduction and Capitalization of Expenditures Related to Tangible Property;" although at the same time, they had announced a proposal to make that temporary guidance permanent. Recently, the IRS announced that taxpayers may rely on parts of the guidance for tax year 2012, but will not be allowed to use the optional method for accounting for rotable parts until 2014 (when the guidance becomes required for all).

The rules in question are the IRS accounting rules for "Materials and Supplies." These regulations provide that a taxpayer may capitalize and depreciate any expenditure for materials and supplies (with certain exceptions), but they impose some limits on when those expenditures can be treated as expense (which can be immediately deducted in the present tax year and are not required to be depreciated).

The new regulations were generally meant to help companies distinguish between expenses related to property, and capital expenditures related to property. Other guidance in the new rule did the following:

- Provided advice on depreciating materials and supplies (guidance that could affect the tax treatment of some inventory held by your customers).
- Clarified that if an expenditure merely restores the property to the state it was in before the work (like a repair), and the restoration does not make the property more valuable, more useful, or longer lived than it was when new, then such an expenditure is usually considered a deductible repair. In contrast, an activity that more permanently affects the longevity, utility, or worth of the property is to be considered capital expenditure (for example, a software upgrade to avionics that provides additional functionality that did not exist before).
- Addressed the tax treatment of materials and supplies.
- Clarified that an exception exists for materials and supplies that are not considered inventory.

Tax Accounting for Rotables

Finally, last year's rules specified that rotable and temporary spare parts are used or consumed in the taxpayer's operations in the taxable year in which the taxpayer disposes of the parts. 26 C.F.R. § 1.162–3T(a)(3). This is important for air carriers because they may use a rotable part for many years before disposing of the part.

(Continued on Page 8)

ASA is blogging!

Check out the two blogs on the ASA website:

- **Cavu Café: Royboy's Prose & Cons**

  and the
- **ASA Web Log by Jason Dickstein**

(Continued from Page 7)

This could make tax accounting for such parts rather difficult, because the finance department will have to track the disposal of the part in order to know when to treat it as a deductible expense. As a matter of real-world practical application, this probably means that such parts have to be depreciated. This guidance could affect recordkeeping practices among air carriers that carry rotable inventory, as well as distributors that carry rotables for use in their own equipment (like forklifts, etc.).

The rules provide an optional alternative for tax accounting of rotables. Under the optional provision, an air carrier would deduct the amount paid to acquire or produce the part in the taxable year that the part is first installed on an aircraft in the air carrier's operations. 26 C.F.R. § 1.162–3T(e)(2)(i). Upon removal, the air carrier would then treat the fair market value of the part as income, and treat the fair market value and also the cost incurred to remove the part as part of the part's basis. 26 C.F.R. § 1.162–3T(e)(2)(ii). The repair cost would also be treated as part of the part's basis. 26 C.F.R. § 1.162–3T(e)(2)(iii). Then, when (if) the part is reinstalled in an aircraft, the basis, as well as the cost of installation, would be deductible in the tax year in which the part is installed. 26 C.F.R. § 1.162–3T(e)(2)(iv).

Under this optional provision, there is a distinct tax advantage to being able to show that you are using rotables in the same year that they are purchased/repaired (so they can be treated as ordinary and necessary business expenses in the year that they are purchased/repaired, instead of carrying-over that deduction to a later year in which they are installed/re-installed). Air carriers with sensitivity to tax issues may keep fewer rotables in their inventories, relying more heavily on distributors to provide rotables on a just-in-time basis, in order to better take advantage of these tax accounting provisions.

The optional rotable accounting provision seems to make sense for rotables with longer lives such as those which may be found in many aviation products. **Under the recent announcement by IRS, though, this optional provision may not be used by the industry until tax years beginning on or after January 1, 2014.** This delay means that the air carriers and others must continue to use the primary rotables accounting

(Continued on page 9)

(Continued from Page 8)

language, which forbids a taxpayer from expensing a rotable until it is disposed-of (and thus likely forces most taxpayers to depreciate their rotables).

Rotable aircraft parts in a distributor's inventory will usually be treated as inventory, rather than under the tax-accounting-for-rotables rule, because the rules define rotables as things that are acquired for installation on the taxpayer's own property:

"rotable spare parts are materials and supplies under paragraph (c)(1)(i) of this section that are acquired for installation on a unit of property, removable from that unit of property, generally repaired or improved, and either reinstalled on the same or other property or stored for later installation"

Distributors typically do not use rotables in this way, so their rotables will be treated as inventory; however repair stations may find some of their parts inventory being treated as rotables under the new rule, particularly if they are purchasing rotables for use on exchange units of loaner units that they own themselves.

Distributors may have rotable parts that they must account-for under these rules if the rotables are used for the distributors own property (like rotable parts for a forklift used in the distributor's warehouse).

The announcement concerning timing of the guidance (that the guidance becomes fully effective in 2014 but may be used at the discretion of the taxpayer until then) can be found at 77 Federal Register 74583 (December 17, 2012). As always, this article is meant to be informative only and it does not constitute tax advice.

CALENDAR OF EVENTS

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July 9-11, 2013 . . . . . *** New Tuesday-Thursday Pattern *** **Four Seasons Hotel** • *Las Vegas, NV*

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March 11-12, 2013 . . . . . **HAZMAT TRAINING** • *Los Angeles, CA*
April 9, 2013 . . . . . **REGULATORY WORKSHOP** • *New York/New Jersey*
April 23, 2013 . . . . . **REGULATORY WORKSHOP** • *Miramar, FL*
April 24-25, 2013 . . . . . **HAZMAT TRAINING** • *Miramar, FL*
July 9, 2013 . . . . . **QUALITY ASSURANCE COMMITTEE MEETING** • *Las Vegas, NV*
September 17, 2013 . . . . . **REGULATORY WORKSHOP** • *Los Angeles, CA*
September 20, 2013 . . . . . **REGULATORY WORKSHOP** • *Seattle, WA*

Industry Events

April 16-18, 2013 . . . . . **MRO AMERICAS** • *Dallax, TX*
May 7-9, 2013 . . . . . **ASA MEMBER PAVILION, AP&M EXPO EUROPE** • *London, UK*

CONTACT US!

ASA Staff is always interested in your feedback. Please contact us with any comments or suggestions.

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REMINDER: ASA MEMBERS GET DISCOUNTED REGISTRATION.

Who should attend ?

This course is intended for all individuals who may come into contact with, or make decisions that affect hazardous material (Hazmat) or dangerous goods (DG).

Why should I attend ?

The U.S. Department of Transportation (U.S. DOT) requires that all individuals engaged in handling hazardous materials must be trained at least once every 3 years. Air Carriers are required to be trained annually, and IATA requires training every 2 years.

This course will focus on shipments of Dangerous Goods under the IATA Dangerous Goods Regulations (a field manual that includes the ICAO technical instructions). This course will also address matters arising out of United States' regulations that are not covered by IATA.

All attendees receive a Certificate of Training stating 49 CFR 172 Subpart H training requirements have been met (upon successful completion of all attendance and testing requirements).