EDITOR'S NOTE: *Mr. Wiener, author of this article on tax savings for aircraft owners and operators, is an associate of the Philadelphia law firm of Wolf, Block, Schorr and Solis-Cohen, of which AOPA's General Counsel, Alfred L. Wolf (AOPA 5), is a partner. This discussion of Federal income taxes continues a service to AOPA members started several years ago. (See The PILOT for March 1958, February 1961, March 1963, March 1964, March 1965, and February and March 1966.)*

Tax

Last year brought several new developments of importance to flyers. 'Ordinary and necessary' business expenses, investment credit suspension and travel 'away from home' are discussed by an attorney

■■ After reviewing their Federal income tax returns, AOPA members, like most Americans, are likely to conclude that their taxes are too high. This is a normal and healthy reaction. As a famous judge, Learned Hand, once wrote, "Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." One of the easiest ways to reduce taxes is to claim every deduction to which one is legally entitled. This naturally includes, in the case of AOPA members, proper deductions in connection with the ownership and/or operation of aircraft.

As can be seen from the accompanying table, most of the deductions associated with aircraft are included in the category of "Business Expenses." In previous articles in this series, considerable emphasis has been placed upon the problems of establishing the required business connection of certain expenditures, particularly where an aircraft is used only partly for business or for business entertainment. (See The PILOT, February and March 1966.) But even after a taxpayer has proven to the satisfaction of the IRS that an expense is related to his business, the deduction still can be denied if the expense is not an "ordinary and necessary" expense of the particular business.

Correspondence from AOPA members indicates some uncertainty as to the precise meaning of this statutory phrase, "ordinary and necessary." In this, the correspondents are in good company, for the same question has troubled tax men for many years. Of the meaning of the phrase, the Supreme Court of the United States once said, "One struggles in vain for any verbal formula that will supply a ready touchstone. The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle." Although life in all its fullness still has not answered all the questions which arise with regard to the meaning of "ordinary and necessary," we are, fortunately, able to answer most of the more

FORM **4136**
U.S. Treasury Department
Internal Revenue Service

Computation of Credit for Federal Tax on Gasoline and Lubricating Oil

Attach this form to your income tax return for calendar year 1966
or other taxable year beginning ..... 1966, ending ..... 19.....

1966

Name (as shown on page 1 of your tax return)

Address (number and street or rural route)

City, town or post office, and State — ZIP code

Type of Use	Gasoline: Number of Gallons Used (A)	Gasoline: Rate of Tax (B)	Gasoline: Column (A) Multiplied by Column (B) (C)	Lubricating Oil: Number of Gallons Used (D)	Lubricating Oil: Rate of Tax (E)	Lubricating Oil: Column (D) Multiplied by Column (E) (F)
1 Nonhighway:						
a. Farms		.04	$		.06	$
b. Motorboat		.02			.06	
c. Aviation		.02			.06	
d. Other (specify)		.02			.06	
2 Local transit systems*		.02				
3 Totals			$			$
4 Total credit claimed (sum of line 3, columns (C) and (F))						$

*Attach a statement with the information required under section 6421 of the Internal Revenue Code and Regulations thereunder. List qualifying "lubricating oil" (see Instruction E) in line 1d column D.

INSTRUCTIONS

A. Who May File.—Any individual, estate, trust, or corporation, including a small business corporation, claiming credit for Federal excise tax on the number of gallons of gasoline and lubricating oil used must file and attach this form to the income tax return. Partnerships are not required to file this form because the credit for Federal excise tax on gasoline and lubricating oil used is claimed by the partners. However, partnerships must attach a statement to their returns, Form 1065, showing the allocation of the number of gallons used of gasoline and lubricating oil to the partners by the type of use as shown above.

Special refund provisions are available, if the credit for any of the first three quarters of your taxable year amounts to $1,000 or more (see Instruction D).

B. Period Covered:

(1) *Calendar Year Taxpayers.*—Enter in the appropriate line the number of gallons of gasoline used after June 30, 1965, and before January 1, 1967, and the number of gallons of lubricating oil used after December 31, 1965, and before January 1, 1967.

(2) *Fiscal Year Taxpayers.*—For years beginning after January 1, 1966, and before July 1, 1966, enter the number of gallons of gasoline used after June 30, 1965, through the end of your taxable year; for taxable years beginning on or after July 1, 1966, enter the number of gallons of gasoline used during your taxable year.

For years beginning after January 1, 1966, enter the number of gallons of lubricating oil used after December 31, 1965, through the end of your taxable year.

C. Must Be Timely Filed For Credit on Income Tax Return.—No credit will be allowed on Form 4136 unless claimed on a timely filed income tax return (including any extension).

D. Quarterly Tax Refund of $1,000 or More.—For any of the first three quarters of your taxable year, a claim, Form 843, may be filed for: (a) refund of tax of $1,000 or more for gasoline used (except for farmers), or (b) refund of tax of $1,000 or more for lubricating oil used. However, no claim will be allowed unless filed on or before the last day of the following quarter. A claim for both gasoline and lubricating oil should provide separate computations following the format as shown above.

E. What Lubricating Oil To Include.—A credit may be claimed for lubricating oil (other than cutting oils and other than oil which has previously been used) which is used otherwise than in a highway motor vehicle. Cutting oils are those oils which are sold for use in cutting and machining operation (including forging, drawing, rolling, shearing, punching, and stamping) on metals. Examples of uses of lubricating oil otherwise than in a highway motor vehicle are oiling plant machinery and lubricating vehicles other than highway motor vehicles, such as bulldozers, power shovels, farm tractors, etc.

Do not include oil: (a) used in a highway motor vehicle, such as a truck, even if it is operated off the highway, (b) sold free of the Federal excise tax on lubricating oil, such

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IRS has developed a new form for "Computation of Credit for Federal Tax on Gasoline and Lubricating Oil" for use by flyers and others claiming refunds on nonhighway-use fuel. Form 4136, which is available at IRS offices, should be filed with the 1966 Federal income tax return.

Savings ON YOUR 1966 INCOME

by RONALD M. WIENER

EXAMPLES OF AIRCRAFT-RELATED DEDUCTIONS

Business Expenses

(Items deductible only if and to the extent related to business use of aircraft)

*Depreciation
Fuel costs
Insurance premiums
Hangar rental
Repairs
Judgment for negligence
Salaries for crew
Meals and lodging while traveling "away from home"
Loss on sale of aircraft

Nonbusiness Expenses

(Items deductible whether or not business related)

Interest on purchase price
*Casualty or theft loss
*Out-of-pocket costs
Charitable work (including Civil Air Patrol)
State fuels taxes (to extent not refunded)

The deductions for many of the above items are subject to special rules and limitations. To be assured of obtaining the maximum allowable tax benefits from your expenditures, consult your tax attorney or accountant. An asterisk (*) before an item indicates that it was discussed in some detail in last year's article, reprints of which are available upon request from The PILOT. The 1966 two-part article (February and March issues) also contains a detailed analysis of the rules and regulations relating to the important question of apportioning expenses between business and nonbusiness use of aircraft.

common questions which are likely to arise.

The closest equivalent to "ordinary and necessary" is probably "reasonable." In general, it can be said that an "ordinary and necessary" business expense is one which is reasonable and appropriate for the particular business and which is reasonable in amount. For this reason, most expenditures which are made as a result of a *good faith exercise of business judgment* will meet the test of "ordinary and necessary."

The foregoing principles can be illustrated by the following example covering a situation as to which AOPA has received several inquiries:

Assume that 75% of the flying hours of a particular aircraft are devoted to purely business flying, and that the other 25% are devoted to personal flying. At the end of a year it may be possible to determine that 75% of the cost of owning and operating the aircraft, i.e., the business portion of the costs, exceeded the amount which would have been expended for commercial air transportation between the points to which the aircraft was flown on business. Nevertheless, 75% of the costs of the aircraft for the year would still be deductible as "ordinary and necessary" business expenses. In weighing the convenience of flying his own aircraft against any increased costs of doing so, a businessman could reasonably choose the convenience.

A second type of inquiry which AOPA has received from its members concerns the deductibility of aircraft operating expenses of training or proficiency flights. At the outset, it should be made clear that, with very few exceptions (one of which is discussed later in this article), expenses of first securing a pilot's certificate are considered personal expenses, even if the certificate is obtained solely for the

purpose of enabling the individual to engage in business flying. Accordingly, not only are costs of flying lessons generally nondeductible, but so also are the costs of operating an aircraft during prequalification training or prequalification proficiency flights.

Once a pilot has qualified for a particular rating, the extent to which the costs of proficiency flying are deductible will depend primarily upon the extent to which such costs are related to the pilot's business. Where the maintenance of flying skills and/or ratings are required for purely business reasons, as would be the case with a professional pilot, unreimbursed expenses of proficiency flying should be completely deductible. On the other hand, where flying is not absolutely required in an individual's business, but nevertheless some business flying is done, these costs would not normally be deductible. For specific advice as to whether you are entitled to a deduction for such costs, review the facts of your particular situation with your lawyer or accountant.

There are, as noted above, very few exceptions to the rule that the initial expenses of obtaining a pilot's certificate are not deductible. One of these exceptions is illustrated by a recent case involving employees of Northwest Airlines. In *Marvin L. Lund v. Commissioner of Internal Revenue*, decided by the Tax Court of the United States on June 13, 1966, several flight engineers employed by the airline succeeded in establishing the deductibility of flight training expenses incurred in the course of obtaining commercial pilot's licenses and instrument ratings.

The facts of the case were as follows:

The taxpayers had been employed by Northwest as flight engineers since the early 1950's. In 1959, shortly before the introduction of jet aircraft, Northwest decided that for safety reasons flight engineers on jets should have commercial pilot's licenses and instrument ratings. The International Association of Machinists (IAM), representing the flight engineers, bitterly opposed Northwest's decision; IAM feared that the flight engineers would be assimilated into the collective bargaining status of pilots. On the other hand, Northwest and the Air Line Pilots Association (ALPA) insisted that there be three pilots in the jet crews. The dispute was not finally settled until July 1963, at which time an agreement was reached whereby flight engineers who qualified as pilots could transfer to service as flight engineers on jets without loss of seniority in ALPA, the union that subsequently represented them.

Pending settlement of the dispute between Northwest and IAM, the taxpayers continued to work as flight engineers on non-jet aircraft. However, they realized that such aircraft would eventually be phased out and thus sought to and did qualify themselves for positions on jets by obtaining the necessary certificates. Even though they held pilot's licenses, none of the taxpayers had ever filled in for either the captain or

the copilot in routine or emergency situations. In fact, the court specifically found that the duties of the taxpayers on jet aircraft were not essentially different from their duties on non-jet aircraft, despite their title of "second officers" when working on jets; futhermore, they were not paid more for services on jets. Although the taxpayers were now qualified to serve as copilots as well as second officers, none of them had ever served as copilots, who received substantially more pay than did the taxpayers.

The taxpayers deducted their flight training expenses on their income tax returns as education expenses. The income tax regulations in effect for the years in question provided that amounts expended by a taxpayer for education undertaken for the purpose of (1) improving skills required in his employment or (2) meeting the express requirements of his employer imposed as condition to the retention of his salary, status, or employment were considered to be "ordinary and necessary" business expenses. On the other hand, educational expenditures undertaken primarily for the purpose of obtaining a new position or a substantial advancement in position were treated as personal expenses and hence nondeductible.

The IRS argued that the costs of obtaining pilot's licenses and instrument ratings did not qualify as deductible expenses under the regulations because taxpayers' skills as flight engineers were not improved thereby and because they could have continued to work on non-jets. The Tax Court held it was unimportant that the taxpayers had acquired new skills, because this was expressly required by Northwest as a condition to the retention of their employment if they were to be able to work on jets. In this regard, it was important that there was no material difference between the taxpayers' actual duties on jets and non-jets, since this fact satisfied the court that the taxpayers had not sought to obtain new positions. The court agreed with the taxpayers that the phase-out of non-jets was inevitable. Because this made the choice between flying on jets and not flying on jets really a choice between working and not working, the court held that obtaining the pilot's licenses and instrument ratings were conditions imposed by the employer, Northwest, to the retention of the taxpayers' employment status. Accordingly, the deductions were allowed by the controlling regulations.

It is no doubt a coincidence that on July 7, 1966, less that one month after the Tax Court's decision in the *Lund* case, the Treasury Department proposed new regulations dealing with the deductibility of education expenses. The proposals would restrict the deductibility of such expenses by providing that no deduction will be allowed for the expenses of education which will lead to qualifying the individual for a new position, speciality, trade, or business, regardless of the purpose for which the education was undertaken. Thus, the proposed regulations would have changed the result of the *Lund* case if they had been in effect for the years there in issue, since it will be recalled that the certificates obtained by the taxpayers in *Lund* qualified them for positions as copilots. The fact that the taxpayers had no intention of ever applying for the position of copilot and in fact had continued to perform the duties of flight engineers (second officers) on jets would not, under the proposed regulations, make any difference; the deductions still would be denied. Not surprisingly, the Treasury's proposed education expense regulations have produced considerable comment and controversy. The proposals have already been revised once, and it remains to be seen whether they will be adopted at all, or, if adopted, whether they will retain their present form.

The foregoing discussion on the deductibility of education expenses provides an excellent illustration of the rapidly changing nature of tax law. The year 1966 seemed to have more than its share of changes. The following paragraphs review those developments which should be of particular interest to AOPA members.

One of the most important developments affecting the aircraft industry in 1966 took the form of an Act of Congress with the colorful title, "An

Act to suspend the investment credit and the allowance of accelerated depreciation in the case of certain real property." Prior to the approval of this act on Nov. 8, 1966, a taxpayer who purchased an aircraft or other piece of equipment for use in his trade or business was entitled to a credit against his income tax in an amount equal to 7% of all or a part of the cost of the item, if the item had a useful life in his business of at least four years or more. If the useful life was between four and eight years, the 7% credit was taken against specified percentages of the purchase price; if the useful life was eight years or more, the credit applied to the entire cost.

The purpose of the investment credit when it was enacted in 1962 was to stimulate investment in plant and equipment. Because of the added stimulus to the economy created by the war in Vietnam, Congress, at the urging of President Johnson, suspended the investment credit until the end of 1967. In general, property acquired or ordered, or on which construction is begun, during the "suspension period"—i.e., between Oct. 10, 1966, and Dec. 31, 1967—no longer qualifies for the investment credit. There are, however, many exceptions and qualifications to the general rule, including a provision that a taxpayer may select as qualifying for the credit up to $20,000 worth of equipment purchased during the suspension period. Accordingly, anyone who purchased, ordered, or took delivery of an aircraft or other piece of business equipment during the suspension period, or is considering doing so, should seek advice from his tax lawyer or accountant concerning the availability of the investment credit. (The suspension of certain methods of accelerated depreciation was also an element of this act; but this suspension only applied to depreciation on real estate.)

While Congress was busy at its task of reviewing and revising the tax laws, the courts continued their unspectacular but important job of interpreting existing laws. One of the most important developments to AOPA members who do any substantial amount of business flying resulted from the decisions in a series of cases involving the deductibility of meals and lodging while traveling "away from home" on business. IRS has construed the phrase "away from home" used in the Internal Revenue Code as meaning away from home *overnight*. Thus, IRS would allow a New York businessman to deduct his costs of meals and lodging on a business trip from New York to Chicago if, for example, he flew to Chicago in the evening, stayed overnight, conducted his business the next morning, and then flew back to New York. But IRS would not allow any deduction for meals purchased by the same taxpayer if he made the trip from New York to Chicago on a morning plane, conducted his business in Chicago during the afternoon, and flew back to his home in New York that same night.

Although this "overnight" rule had been questioned in a few cases prior to 1966, it was still considered to have considerable vitality. During 1966, however, no fewer than three separate courts rejected the "overnight" rule as an absolute standard. The Court of Appeals for the Sixth Circuit, in deciding the case of *Correll v. United States* on Nov. 29, 1966, stated, "In an era of supersonic travel, the time factor is hardly relevant to the question of whether or not travel and meal expenses are related to the taxpayer's business and cannot be the basis of a valid regulation under the present statute." The Court of Appeals for the Eighth Circuit, which had already rejected the rule in 1962, expressed sentiments similar to those of the Sixth Circuit in again rejecting the rule in the case of *United States v. Morelan*, decided Feb. 4, 1966. The third court to reject the rule last year was the Tax Court of the United States in the case of *William A. Bagley v. Commissioner of Internal Revenue*, decided May 4, 1966. The Government has appealed the decision in the *Bagley* case to the Court of Appeals for the First Circuit. If that court reverses the Tax Court and upholds the Government's position, it is quite likely that the Supreme Court will be asked to review the question. On the other hand, if the First Circuit also rejects the "overnight" rule, the Government is expected to capitulate and concede the deductibility of meals on nonovernight business trips at least under some circumstances. In the meantime, AOPA members should consider protecting themselves by deducting their expenses for meals on nonovernight business trips. And if an individual incurred substantial expenses of this nature in the past few years and did not claim deductions for them, he should consider with his tax advisor the possibility of filing a claim for refund of taxes.

The above cases involving the "overnight" rule really concern the interpretation of the word "away" in the phrase "away from home." It is interesting to note that questions also arise concerning the definition of the word "home" as used in the same phrase. It is a fairly well-established concept of the tax law that one's residence is not necessarily his "home" for tax purposes, strange as this may seem. Rather, "home" refers to the general locale of the taxpayer's place of employment. For example, an individual who lives in the area of New York City but commutes to a job in Washington, D.C., cannot deduct his traveling expenses nor the cost of his meals in Washington.

The Supreme Court of the United States has agreed to review a case involving another peculiarity of the definition of "home." This is the so-called "temporary" versus "indefinite" rule, concerning individuals who are stationed at a business post away from their regular post (their tax home) for temporary or indefinite periods. If the assignment is held to be "temporary," the taxpayer is considered to be "away from home" and may deduct the cost of meals and lodging while at the new

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post. But if the assignment is "indefinite" the taxpayer is considered to have brought his "home" with him! As a rule of thumb, the IRS apparently considers periods less than one year to be "temporary" and longer periods to be "indefinite."

In the case before the Supreme Court, a Marine Corps captain, attached to an air squadron in California, was assigned to duty in the Far East. Marine Corps orders forbade the taxpayer to take his family with him, and they remained in California. The Tax Court found that the taxpayer's assignment was indefinite, so that his "home" was his principal duty station in Iwakuni, Japan; accordingly, the Court disallowed the captain's claimed deduction for meals purchased there. The Court of Appeals for the Ninth Circuit decided that a taxpayer's "home" does not move to a new post of duty where it is unreasonable or impossible for him to move his family residence to his new place of employment. The Circuit Court reversed the decision of the Tax Court and held that the expenses in this case were deductible. In Oct. 1966 the Supreme Court agreed to review the case; the Court's decision probably will be announced before the summer. The outcome of this litigation is of obvious interest to AOPA members who are connected with the Armed Forces, and to many who are not. Be sure to ask your lawyer or accountant where your "home" is!

At this point, it is worthwhile to point out one element common to all of the cases discussed in this article. In every case the taxpayers have, so far, succeeded in establishing their right to deduct items which the IRS claimed were not deductible. This is an important lesson to keep in mind, for it demonstrates that the position of the Government, while usually correct, is not always so. Among the valuable services performed by a competent tax consultant, whether lawyer or accountant, is advice on when to try to obtain a tax deduction or other benefit despite the probable opposition of the IRS.

AOPA members who have gotten an early start on their 1966 income tax returns probably have noticed that Form 1040 now contains a line (Line 20) for claiming the refund of Federal gasoline tax used for nonhighway purposes as a credit against income tax. For most taxpayers, this simplified procedure replaces the old system of filing separate forms to claim Federal gasoline tax refunds. The new procedure was explained in an article by John S. Yodice (AOPA 199738), AOPA's Washington counsel, in the December 1965 issue of The PILOT. Reprints of Mr. Yodice's article are available upon request, in combination with a reprint from the March 1966 issue of The PILOT of AOPA's report "State Gas Tax Refunds."

When compared with other groups of taxpayers, AOPA members did not fare badly as a result of tax law changes in 1966. Although it is impossible to predict what 1967 will bring, we will undoubtedly see a number of significant changes in the tax law, some of which will affect you. Be alert for them, and perhaps you will be able to cut that onerous tax bill. □

Ninety-Nines Hold Photo Contest

The Ninety-Nines have extended to almost 3,000 members an invitation to attend the International Fly-In, which will be held at Washington, D.C., June 28 to July 2. As a convention highlight, a campaign to persuade fly-in participants from foreign countries to "See The USA" has been launched. In connection with this campaign, the Ninety-Nines are holding a photo contest to obtain the most beautiful color aerial photographs of the United States.

These photographs will be included in invitation folios which will be distributed abroad. There will be in each folio, also, an invitation from each governor to the people of the world to visit America, particularly his state.

The contest is open to amateur and professional photographers, but again—only *color aerial* shots will be judged. Criteria are photographic excellence and how identifiable the subject matter is with the state it represents. A contestant need not reside in the state for which he submits an entry.

The country has been divided east and west of the Mississippi, and entries must be submitted to the coordinator for that section. Here are the addresses for east and west, respectively:

99s' Photographic Contest
Box 30099
Washington, D.C. 20014

99s' Photographic Contest
Box 99
Pacific Grove, Calif. 93950

There will be a separate board of judges for each section. Fred Maroon and Robert E. Gilka have already agreed to judge the east, and Ansel Adams and Brett Weston will do the honors for the western group. All of these men are well-known in the field of photography.

General rules for participation in the contest are as follows: submit positive transparencies including slides or color negatives, but each negative must be accompanied by a print not larger in size than 8 by 10 inches; no more than four positive transparencies, including slides, or four color negatives with prints may be submitted and must have been taken within the last three years; put the title of the photo, state in which it was taken and the contestant's name on each slide and print. The contest closes midnight April 30, 1967, and winners will be notified by June 15, 1967. □