EDITOR'S NOTE: Mr. Keller, 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, February and March 1966, March 1967, and March 1968).*

Expenses for flight training, aircraft as 'entertainment' facility, and claiming Federal gasoline tax credit and deductions for state sales taxes are among topics discussed in The PILOT's annual tax article

TAX TIPS FOR FLYERS

by ROBERT I. KELLER

■ ■ Although Plato, in "The Republic," stated that "where there is an income tax, the just man will pay more and the unjust less on the same amount of income," the ethics of the American taxpayer are much better expressed by Judge Learned Hand in his 1947 dissenting opinion in *Commissioner of Internal Revenue v. Newman:*

> Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.

It is in this spirit that The PILOT annually publishes an article on taxation.

The year 1968 was a quiet one on the tax front for AOPA members. Aside from the enactment of the tax surcharge, there was no major tax legislation affecting flyers, nor were there any highly significant court decisions. Accordingly, this year's article will be devoted to answering some pertinent questions which were (or might have been) received by AOPA regarding the application of the tax laws to general aviation.

It is the author's hope that the following questions and answers will give the AOPA members a start in "so arranging [their] affairs as to keep [their] taxes as low as possible." However, the reader should be aware that each question reflects one particular set of facts and circumstances. The more the facts and circumstances of your particular situation tend to diverge from those assumed in the question, the less likely it is that the answer given will apply to your case.

Non-Highway Gasoline Tax Credit

QUESTION 1:

I properly applied for a credit for gasoline tax payments, with respect to gasoline used for my airplane, by entering the amount to which I was entitled on line 19 of page 1 of my 1967 income tax return. However, because of certain difficulties, I applied for and received an extension from the Internal Revenue Service for filing my 1967 tax return until May 1, 1968, when the return was in fact filed. I have now been informed that my claim for a credit of gasoline tax has been denied. Is there anything I can do?

ANSWER:

Although you can do nothing at the moment, legislation may be forthcoming which will allow you to receive this credit.

Since June 30, 1965, the Internal Revenue Code has provided that taxpayers entitled to gasoline tax refunds must claim such refunds as credits against tax on their Forms 1040. Under present law, a failure to claim the credit on or before the date prescribed for filing your income tax return (April 15 for most taxpayers) results in permanent loss of the credit. As a result, a late-filed claim is barred notwithstanding circumstances that would excuse the late filing of the income tax return in which the credit may be claimed.

The rule granting the taxpayer only 3½ months after the close of the taxable year to claim this refund predated the 1965 law which introduced the new method of claiming the credit on income tax returns, and makes absolutely no sense today. Nevertheless, when a taxpayer for any reason filed his 1967 income tax return claiming these credits after the due date for the return he found his claim for credit was denied, no matter how reasonable the delay for filing the return. Naturally, great confusion was created by having a shorter period for claiming the credit than for filing the return on which the claim had to be filed.

H.R. 17332 was a bill introduced in 1968 to extend the time for claiming a credit or refund of these taxes to three years after filing the income tax return in which the credit should have been claimed. When Congress adjourned on October 14, 1968, it sent several tax bills to the White House, but H.R. 17332 was not among these. However, the bill has been reintroduced in the 91st Congress and, if approved, will apparently apply retroactively to gasoline used after June 30, 1965. Be on the alert for the passage of this bill in 1969; if it is passed, be certain to contact your tax adviser to determine whether or not you are entitled to a refund.

QUESTION 2:

On Jan. 30, 1968, I filed a Form 843 with the Internal Revenue Service claiming a refund of Federal gasoline tax payments with respect to gasoline used for my airplane, instead of properly claiming credit for the taxes on line 19 of page 1 of my 1967 income tax return. The claim was for gasoline used for non-highway purposes during the entire calendar year 1967, and I did not make any reference to this credit on my 1967 tax return. Am I still entitled to a refund for 1967? Does it matter what procedure I follow in 1968 and later years?

ANSWER:

Yes, to both questions. The Internal Revenue Code provides that, if gasoline is used for non-highway purposes, the purchaser is entitled to a refund of two cents for each gallon of gasoline so used. For the great majority of cases, not more than one claim is allowed with respect to gasoline used during any taxable year unless a claim for refund (credit) is filed not later than the time prescribed for filing an income tax return for such taxable year.

The proper way of claiming this credit is, of course, to include a Form 4136 with your tax return and insert the amount of the credit on line 19 of that return. Nevertheless, the Internal Revenue Service announced in 1968 that in a case such as yours, where the refund claim was filed on or before the time prescribed for filing

your income tax return for the year during which the gasoline was used, the claim "may" be associated with your income tax return and a credit in the amount of the payment claimed on the Form 843 "may" be allowed against the tax due on the return. (See Revenue Ruling 68-403.) You will save yourself considerable inconvenience in the future, however, if you do not depend on this ruling, but rather claim the credit on your income tax return.

QUESTION 3:

Former President Johnson in his last budget message proposed various excise tax hikes. If such proposals are enacted, how will they affect aircraft owners?

ANSWER:

President Johnson in his budget message for fiscal 1970 proposed specific increases in the excise tax paid for gasoline and other fuel oil by the aviation industry. The charges would be effective July 1, 1969, and would mean an increase from two to eight cents per gallon on gasoline used in general aviation, rising to 10 cents on July 1, 1971. It would also mean a new eight cents per gallon tax on jet fuel used in general aviation, also rising to 10 cents on July 1, 1971. An increase in excise rates, applicable specifically to gasoline and other fuel used by general aviation, would apparently mark the end of the flyer's tax credit for gasoline used for non-highway purposes.

Flight Training As A Deductible Educational Expense

QUESTION 4:

I am a retired commander in the United States Navy. Since my retirement I have worked as a business and engineering consultant, to which work I have devoted my time exclusively. A few years ago, while still on active duty, I purchased a 1949-built Cessna 195 aircraft for the sum of $9,425.

While in the Navy, I was an aviator and a research and development engineer in the field of aviation. I do not use my aircraft in my current employment as an engineering consultant, but I feel that I must have this aircraft in order to maintain my skill as a pilot in case I ever need to utilize that skill, at a later date, in order to produce income. Moreover, one time during the last three years I did receive $225 as a charter fee on my aircraft.

Am I entitled to deduct the maintenance expenses and depreciation of my aircraft?

ANSWER:

No. Such expenses do not meet the requirements of the Treasury regulations under Section 162 of the Internal Revenue Code for deduction as an "educational expense." The regulations permit a deduction of expenditures incurred for education, if the purpose of the education is to maintain or improve skills required by you in your employment or trade or business. However, you are not in the business of flying the plane for charter, since an isolated instance of chartering your aircraft does not constitute a business. Moreover, you did not use your aircraft in your business as a consultant in the years in issue. As noted by the Tax Court in 1968, "If these expenses relate to any trade or business whatsoever they relate to a business [you] perceived [you] might have to resume. . . ." The courts have often held that this is not sufficient to qualify the expenses as deductions under Section 162. (See the Tax Court decision in *C. Fink Fischer v. Commissioner of Internal Revenue*, decided on April 29, 1968.)

NOTE: The expenses also fail to qualify as deductible business expenses since they were not proximately related to your employment as an engineering consultant.

QUESTION 5:

I am a senior auditor in an accounting firm and occasionally travel out of town on firm business. The firm allows its employees to use private, noncommercial facilities if work and time schedules permit, and reimburses employees for travel expenses based on mileage at commercial air rates when another method of travel is used.

Last year I spent $1,000 for flying time and lessons to obtain a private pilot's license. My employer did not ask me to take these lessons and did not reimburse me for their cost. I was permitted to use private aircraft to travel on the firm's business, so long as this did not require additional travel time. I have always had an interest in flying, and since I obtained my private pilot's license I have occasionally piloted an aircraft on personal and family trips.

Am I entitled to deduct the $1,000 I spent for flying time and lessons?

ANSWER:

No. According to a recent Tax Court decision, there is an insufficient connection between the expenditures and your business as an employee of the accounting firm. (See the Tax Court decision in *Paul Katz v. Commissioner of Internal Revenue*, decided on Feb. 1, 1968.)

The income tax regulations permitting a business expense deduction for "expenses for education" refer to education which either maintains or improves skills required in a taxpayer's employment or which is required by his employer to retain his salary, status, or employment. Clearly, these expenses were not "required" by your employer. Moreover, they were not "required" in your employment.

As an employee-accountant your business is to perform accounting services for your employer's clients. The end result of your work is not affected by the mode of transportation used. If the cost of flying a private plane is less than the cost of commercial transportation, the only effect is on the final bill to the client; and this is your employer's concern, not yours as an employee.

Moreover, your employer never suggested that you take flying lessons, but merely permitted you to use a private plane for business travel as an accommodation to you. Combining these factors with your long-term interest in flying and the personal use you made of your new skills, the court will consider the expenses in question non-deductible personal expenses.

QUESTION 6:

I am, and have been for many years, a qualified flight engineer employed by a major airline. A number of years ago, just prior to the introduction of jet-powered aircraft into service, the management decided that each flight crew member, including the flight engineer, should be a qualified pilot. This was done for safety considerations, in order to make certain that in routine and emergency conditions, the flight engineer could relieve the pilot and/or co-pilot. Therefore, in addition to a flight engineer's rating, I had to obtain a commercial pilot certificate with an instrument rating. Prior to this management decision, as a flight engineer I had no need for pilot training and was not expected to relieve either the pilot or copilot in emergency or routine situations.

It was clear to me that if I intended to remain a member of the flight crew, rather than revert to my former position as a ground mechanic, I would have to obtain the required training. I paid for the cost of lessons and flight time out of my own pocket. The new title given to flight engineers on jet crews was "second officer," but the position was equivalent to that of flight engineer, and the duties were essentially the same.

Am I entitled to deduct the cost of my flight training?

ANSWER:

The answer to this question is debatable. Where amounts are expended by a taxpayer for education undertaken for the purpose of maintaining or improving skills required in his employment, or meeting the express requirements of his employer imposed as a condition to the retention of his salary, status, or employment, such amounts are usually considered to be ordinary and necessary business expenses deductible under Section 162 of the Internal Revenue Code.

The Treasury regulations in effect when the case of *Marvin L. Lund v. Commissioner of Internal Revenue* was decided in 1966 stated that educational expenses were not deductible if the education was undertaken primarily to obtain a new position. The Tax Court in the *Lund* case allowed the taxpayer's deduction, since such training was required by the employer as a prerequisite for holding the equivalent position of second officer on the jet aircraft. The fact that this training also qualified Lund to be a copilot was immaterial, since the primary purpose of the training was to retain a similar position with increased responsibilities.

However, on May 1, 1967, the Treasury adopted new regulations which

stated that even if the "employer requirement" test was met, educational expenditures would be disallowed if the education qualified the taxpayer for a new trade or business. On first impression, this would seem to prevent your deduction under the new regulations, since the expenses you incurred seem clearly to qualify you for a new trade or business as a pilot. However, how literally this regulation will be applied by the Internal Revenue Service to your case cannot be determined. The uncertainty is compounded by the fact that the Internal Revenue Service announced its agreement with the decision in the *Lund* case under the old regulations.

An Aircraft As An Entertainment Facility

QUESTION 7:

I own an aircraft which I use for both personal and business purposes. My use of the aircraft in 1968, which I can properly substantiate, is divided as follows (in terms of percentage of hours flown during the year):

Personal use	*45%*
Goodwill entertaining	*25%*
Directly related entertaining	*20%*
Pure business use	*10%*

By "goodwill entertaining" I mean the time spent taking prospective customers up in the aircraft with the hope that the person I am entertaining will continue to be my customer or may become so in the future. Little or no business is discussed during these flights. Very often, however, I will have my pilot take me and a customer up in the aircraft, at which time we will have a luncheon meeting to discuss specific and current business dealings. I refer to such flights as "directly related entertaining." Pure business flights are those unrelated to entertainment (e.g., a flight out-of-town to see a customer).

My yearly expenses relating to the aircraft and to each specific flight may be broken down into the categories of direct and indirect expenses. The direct expenses of a flight include gasoline and other like items. My indirect expenses include such costs as depreciation, repairs, insurance and painting of the aircraft.

Which of these expenses may I deduct and in what amounts?

ANSWER:

All of the direct expenses (gasoline, etc.) incurred during a flight which is a "pure business flight" or one which you term "directly related entertaining" are, of course, fully deductible. In addition, since your aircraft qualifies as an "entertainment facility" under the Treasury regulations, you may deduct 30% of your indirect expenses (depreciation, repairs, etc.).

The indirect expenses (10%) relating to use of the plane for purely business purposes, unrelated to entertaining, are deductible whether or not your aircraft qualifies as an entertainment facility. However, in order to deduct any other indirect expenses with respect to a facility used for entertainment, it must be shown that the aircraft is used more for the furtherance of your business than it is used for other purposes. The Treasury regulations state that, in the case of an airplane, the taxpayer must show that more than 50% of the hours flown were in connection with travel considered to be an ordinary and necessary business expense. In computing the 50%, "pure business," "goodwill entertaining" and "directly related entertaining" are all considered. Therefore, your aircraft qualifies as being used "primarily for the furtherance of [your] trade or business," since 55% of the hours flown were business hours.

However, although 55% of the hours flown are business hours, only 30% of your indirect expenses (i.e., 10% for pure business use and 20% for directly related entertaining) may be deducted. This is because the use of your aircraft for goodwill entertaining is considered a "business use" *only* in determining whether the 50% test has been met. The deductible portion of indirect expenses is only that percentage of the total indirect expenditures which equals the percentage of hours flown for "pure business" and "directly related entertaining."

Depreciation Of An Aircraft

QUESTION 8:

I understand that the "guideline" life for depreciating my business aircraft is six years. However, I believe that under all the facts and circumstances of my situation, a shorter life should be used. Is it possible for me to obtain a ruling from the Internal Revenue Service on the useful life of my aircraft?

ANSWER:

Not under current Internal Revenue Service practice. Generally, the Internal Revenue Service will not issue an advance ruling relating to the useful lives of assets because of the inherently factual nature of the problems involved. We understand that, despite some rumors to the contrary, the National Office of the Internal Revenue Service will not, at the present time, issue rulings on the useful life of aircraft. Apparently, in the case of an aircraft, a complete prohibition against rulings is presently in effect.

However, if you and your tax adviser believe that you can justify a life shorter than six years, you should, by all means, depreciate your aircraft based on that shorter life, and "fight it out" later.

Deduction Of Sales Tax

QUESTION 9:

I live in Philadelphia, Pa., with my wife and two children. My adjusted gross income for 1968 was $30,000. During 1968, I purchased a new automobile for $5,000, plus 6% Pennsylvania sales tax of $300. In addition, I also purchased in 1968 a Cessna Skyhawk 172 *for $12,750, plus sales tax of $765.*

How much sales tax am I entitled to take as a deduction on my 1968 income tax return?

ANSWER:

You will be entitled to deduct sales tax of $1,324.

All retail sales taxes, whether imposed by a state or a city, are deductible by the consumer if imposed on him. If you itemize your deductions, you may utilize the published schedules of standard sales tax deductions contained in the official instructions for Form 1040. These schedules are graduated according to adjusted gross income and exemptions. A deduction based on the schedules will normally be accepted without question. The guidelines for Pennsylvania, which has a 6% sales tax, indicate that a taxpayer with a family of four and an adjusted gross income of $30,000, is entitled to a deduction of $259.

A taxpayer who claims a deduction in excess of the amount indicated in the table normally will be required to substantiate his entire deduction. Sales tax paid on the purchase of an automobile is the only item that normally can be added to the table amount without triggering the necessity of substantiating the aggregate amount—only the tax on the automobile need be substantiated. However, a recent newsletter from the District Director for Philadelphia indicates that four other classes of items may also be added to the table amounts, if they are taxed at the general sales tax rates. The four items are boats, airplanes, mobile homes, and the purchase of the materials to build a new house.

Consequently, you are entitled to add the $300 sales tax paid on your automobile and the $765 paid on your aircraft to the table amount of $259, for a total deduction of $1,324. Of course, if you are able to establish that you paid an amount larger than $1,324 during 1968, you are entitled to deduct that larger amount. However, this is normally a very difficult task.

NOTE: The position of the Philadelphia District Director may not reflect a national policy. Consequently, readers outside the Philiadelphia district should have their local policy investigated. □

AUTHOR'S NOTE: A former Commissioner of Internal Revenue once observed, "Just as democracy needs a well-informed electorate, so a self-assessment tax system needs well-informed taxpayers." When it comes to your taxes, knowledge can save you money. It is the hope of the author that this article has taken the reader one step closer to the status of a "well-informed taxpayer."

Of necessity, only a very small area of the tax law has been covered by the foregoing questions and answers, and no article, however lengthy, can hope to substitute for the advice that can be given a taxpayer only by a competent tax attorney or accountant.
