Tax Tips For Flyers

Federal income tax time is here again. Significant changes have been made in the law, and IRS has been upheld in some important rulings in regard to business use of personal aircraft

by WILLIAM A. ROSOFF

EDITOR'S NOTE: Mr. Rosoff, 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, March 1968 and March 1969.)*

■■ The past year was a year of tremendous upheaval in the tax law. Congress, answering the outcry of a taxpayers' revolt against the preferred treatment afforded some taxpayers, passed at year's end the Tax Reform Act of 1969. Affecting every taxpayer, the new Act completely revamps the income tax law.

While most of the changes in the law do not particularly affect flyers in their capacity as flyers, they do affect them greatly as taxpayers. The act covers items from an increase in the amount of personal exemptions to a special tax on taxpayers receiving certain tax preferences or "tax loopholes." While most of these provisions apply to tax years beginning after Dec. 31, 1969, some apply to years beginning before that date, and many affect the taxation in later years of transactions entered into in 1969. Consequently, taxpayers should be particularly careful to seek the advice of tax counsel before entering transactions or filing their 1969 returns.

Investment Credit Terminated

One change in the tax law which is of special interest to some aircraft owners and pilots is the termination of the investment credit.

Until the new Act, a taxpayer purchasing an airplane was generally entitled to a credit of 7% of the cost of the plane if it had a useful life to him of eight years or more and was to be used exclusively in a trade or business or otherwise used for the production of income.

The credit, unlike a deduction from income, was deductible directly from the income tax otherwise payable by the taxpayer, and consequently was quite valuable. The credit has now been completely eliminated for property acquired after April 18, 1969.

To mitigate the effect of the termination, the Act provides a number of transition rules which apply to transactions that were already in progress on April 18, 1969. Perhaps the rule applying to the greatest number of people is the "binding contract rule." Under this rule if a taxpayer had a binding contract on April 18, 1969, and at all times after that, for the acquisition of an airplane, or other property qualifying for the investment credit prior to the Act, the investment credit will still be available for that property so long as the property is placed in service by Dec. 31, 1975.

Other Developments

Aside from the changes in the law brought about by the Tax Reform Act of 1969, the law continued to develop in areas of importance to airplane owners and pilots. There were cases and rulings in 1969 involving the allocation of airplane expenses between business and personal use, the availability of a deduction for the cost of flying to maintain minimum flying skills, the depreciation of an aircraft, and a 1968 Ruling of interest relating to excise taxes on airplane use. Unfortunately, flyers fared badly in many of these published disputes with the IRS. However, the IRS was not invincible in its disputes with flyers, and the taxpayer losses in no way indicate that it will generally not pay to dispute the IRS.

Business Use Of An Airplane By An Employee

A number of cases flyers lost involved attempts to dispute the Internal Revenue Service's disallowance of business deductions for the use of their planes. At least two employees using their planes for their employers' business ran into a roadblock in trying to deduct their costs.

The Treasury Regulations governing deduction of business expenses provide that "[b]usiness expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business. . . ."

In the case of *John T. Harley, Jr. v. Commissioner*, the question arose of whether an employee who voluntarily flies on business can take a deduction for his costs which are not reimbursed by his employer. Harley was a sales representative for Fisher Governor Company in 1964. He was required to travel around the country in his job, and commercial flight connections were somewhat difficult. He avoided this problem by use of his own plane to do business flying and also later received a promotion attributed by him to the impression his plane made on customers. Fisher reimbursed his costs to the extent they equalled the cost of a comparable commercial flight, but would not reimburse any additional amount.

Aside from flying on Fisher's business, Harley also flew to a number of properties he owned in Tulsa, Okla., and El Dorado, Ark. The properties had income-producing potential and were producing some income. He had grown up in Tulsa and his mother lived there.

Harley deducted his airplane expenses related to these trips. The IRS disallowed the deduction, and when Harley took his case to the Tax Court the Court agreed with the IRS, saying that Harley's only trade or business was earning his salary, and it was neither necessary that he fly to retain his employment nor was any advantage gained in earning his salary by flying his own plane. The Court felt that the employer's refusal to pay the amount beyond the commercial plane rate indicated that it did not believe the taxpayer's flying was to the advantage of the corporation.

Although the Internal Revenue Code allows deductions for expenses related to the management, conservation and maintenance of income-producing property, no deduction was allowed to Harley for the visits to his properties because he merely looked at the properties, and the Court felt the visits were not reasonably related to the properties' management, conservation or maintenance. The Court noted that it had the distinct feeling that Harley's flights were personal ones.

Robert G. Fairburn found much the same problem as Harley. Fairburn was the beneficiary of a trust controlling a block of Keyes Fibre Company, Inc., stock. Keyes was a paper pulp supplier with its principal offices in Maine. Fairburn also was employed by Keyes as a consultant and chairman of the board of directors. He felt that it was impor-

tant for marketing that New York be the center of Keyes operations. To this end he established himself in Keyes' New York offices in an attempt to revitalize its business. Because his work required a great deal of travel around the country, and commercial plane connections were often bad, Fairburn bought a plane for business use. He had no interest in flying for sport. Keyes reimbursed him for commercial flights but did not reimburse him for the cost of his own plane. Fairburn deducted expenses of operating his plane on his tax returns for 1961 and 1962. But once again the IRS disallowed the deduction and was upheld when Fairburn took the case to the Tax Court.

The Court, in *Robert G. Fairburn v. Commissioner*, again said that Fairburn's business was earning his salary, and that the expenditures were neither required to keep his salary nor did they have any direct bearing on his salary. After noting that Keyes neither requested nor required the expenditures, the Court concluded that Fairburn bought the plane for his personal convenience in order to enjoy the comfort he had enjoyed with his former employer, who had supplied him with a plane for his business use. The final outcome of Mr. Fairburn's excursion to the Courts is still, however, in doubt, since he has decided to appeal the case and that appeal is now pending.

The reasoning of the *Harley* and *Fairburn* cases poses substantial difficulty for employees seeking a business deduction for the unreimbursed expenses of their own plane used on their employer's business. As can be seen, they purport to require that the use of the plane have a bearing on the employee's personal income rather than on his employer's profit. Employees using their planes on their employer's business, therefore, should be careful to check with tax counsel before deducting these items.

Some Trips By Doctor Held Not Deductible

However, employees were not alone this year in being denied a business deduction. In a third case this year involving the allocation of plane costs to business expenses, Dr. Robert H. Cowing, a Massachusetts physician, had no better luck in obtaining business deductions for his flying as a self-employed taxpayer than did Messrs. Fairburn and Harley. Both Dr. Cowing and his wife were instrument pilots. Learning to fly partly to facilitate his attendance at medical meetings, Dr. Cowing took many plane trips to medical and pilots' conventions from 1963 to 1965, often accompanied by his wife acting as copilot. In keeping a log during this period, with flight origin and destination, Dr. Cowing marked each business trip.

On these trips the doctor and his wife made intermediate stops and side trips. For example, a trip to a three-day medical convention in San Francisco, took Dr. Cowing 15 flying days, with numerous stops including Las Vegas.

The trips included a 1963 flight to the AOPA convention in Florida. One of his reasons for attending the meeting was that he was an officer, a shareholder, and a director of a corporation owning an airport, aircraft and hangars, and the meeting was important to its business. Another of his trips to Florida was to a meeting of the Flying Physicians. On this trip he stopped off at Nassau, where another corporation in which he was a shareholder and officer owned property.

The doctor deducted approximately 90% of the costs of operating his aircraft in each year, which had a loose relationship to the proportion of hours flown on trips designated in the log as business over the total hours flown. He also took deductions for airplane depreciation, investment credits on the costs of planes, and deductions for the cost of meals and lodging on trips designated as business trips.

The IRS allowed approximately 31% of the cost of operating the aircraft in 1963, 50% in 1964, and 58% in 1965. Similar drastic reductions of the other deductions and credits were made.

When the doctor took his case to the Tax Court, the Court upheld the IRS's determination on all but one trip. The Court's reasons were: (1) that expenses applicable to his wife were not deductible because she was not needed for business and was not needed to help operate the plane; (2) that the many stops on the doctor's trips indicated that a good portion of the trips were personal; and (3) that his business reasons for going to the AOPA convention and for going to Nassau during the Flying Physicians' meeting did not make the trips deductible since he was an uncompensated employee and the stock paid no dividends. The Court, in the same vein as the *Harley* and *Fairburn* Courts, said that being an uncompensated employee was not a trade or business, and that the trips were not related to the management, conservation or maintenance of the taxpayer's income-producing property. Rather, these expenditures, it concluded, were spent on the corporation's trade or business, as opposed to the doctor's. A final reason the Court disallowed some expenses was that some of the doctor's logbook was incomprehensible, and he presented no satisfactory evidence at trial of the purpose of the trips involved in the indecipherable portion of the log to fill the gap.

The only deductions the Court allowed which the IRS disallowed were the deductions applicable to a trip to Washington, as president of the medical staff of a hospital, to obtain Federal aid for a wing to the hospital. The doctor was accompanied on the flight by a hospital administrator and a trustee of the hospital. The Court did not explain why this related to the doctor's income as an employee rather than to the hospital's business.

Flying Costs As Deductible Educational Expenses

On a more optimistic note is the case of Keith W. Shaw, a doctor who was permitted to deduct his flying expenses because his flying served as training to maintain and improve his skills as a medical examiner. Shaw, a major in the Air Force Reserve, had been an Army Air Force flyer in World War II, and later became a junior medical examiner for the Bureau of Aviation Medicine of the FAA. There was no requirement that he fly to maintain his job as medical examiner, but it was encouraged to make the doctors better able to judge the medical fitness required by a flyer. Shaw rented a plane in 1961 and part of 1962. In 1962 he bought a plane. He deducted his rental expenses and operating costs on his income tax return in 1961 and 1962, and his depreciation for the latter part of 1962 for the plane he had purchased. The IRS again disallowed the deductions, and Shaw in turn again took the case to the Tax Court.

The current Treasury Regulations on the deductibility of trade or business expenses provide that education expenses are in general deductible if the education "[m]aintains or improves skills required by the individual in his employment or other trade or business, or . . . [m]eets the express requirements of the individual's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation." An expense will not be deductible under current regulations, even after it meets these requirements, if the education "is required of him in order to meet the minimum educational requirements for qualification in his employment or other trade or business . . . [or the education] is part of a program of study being pursued by him which will lead to qualifying him in a new trade or business."

Since Shaw's deduction in issue for 1961 involved deductions applicable to less flying time than the 40 to 50 hours that the evidence at trial showed was required to maintain a flyer's skills, the Court allowed the full deduction for that year. It felt that these expenditures maintained or improved skills required by the individual in his employment. Shaw was not so fortunate for 1962, and the Court upheld the IRS in disallowing the deductions. However, this was because Shaw failed to supply sufficient evidence of the amount of his expenditures, not because he could not obtain the deduction if he could have proved that the money was spent.

Excise Taxes

While the Federal income tax is the most popularly discussed tax, there are other taxes which are of importance to flyers. On June 24, 1968, the IRS issued a ruling relating to excise taxes which could catch many flyers and airplane owners unaware and result in serious consequences.

The Internal Revenue Code imposes a 5% excise tax on the amount paid for transportation by air if the transportation originates in the continental United States, or certain portions of Canada or

(Continued on page 66)

(Continued from page 64)
Mexico, and ends within any of these areas. Certain other travel within the United States is also included, and some portion of the flights mentioned outside of the United States is exempt. There are also a number of exceptions to the tax, one of which is for an aircraft with a gross takeoff weight of less than 12,500 pounds and a passenger capacity of less than 10 adult passengers including a pilot, except when such an aircraft is operated on an established line.

The IRS was asked by a taxpayer to rule on whether the excise tax was payable in the following circumstances. A corporation owned an aircraft and employed a pilot. The pilot and plane were used by the owner and by a number of other related corporations including a subsidiary of the owner. The costs of the aircraft were shared by each of the corporations.

The IRS ruled that the payments to reimburse the company that owned the plane for the shared expenses were subject to the excise tax. This ruling would appear not only to make payment taxable when costs are shared by a parent and subsidiary, but also when shared by a corporation and its employees or shareholders. Moreover, even if there is no reimbursement, it is possible that the tax will be imposed on the portion of the expenses of operating the aircraft which is applicable to the non-owners' use. If no return has been filed for this tax, the IRS can go back an unlimited amount of time to impose the tax on prior years, charging 6% interest and possibly imposing a 25% penalty. Prior to Nov. 16, 1962, the tax was 10%.

It is absolutely essential, in light of these developments, that anyone owning an aircraft or sharing the use of a plane consult his tax adviser about the application of this excise tax, unless the plane has clearly less than 12,500 pounds gross takeoff weight and has far under 10 seats by any possible count. If this tax is ignored, serious consequences might result.

Depreciation Of An Airplane

Finally, returning to the income tax, we find a taxpayer who had the thought (or whose tax adviser had the thought) that he might be able to legitimately depreciate over one-half of the cost of his plane even though he used the plane only one-half for business, in spite of the fact that normally if an asset is used only 50% for business, only one-half of the annual depreciation is deductible.

The case arose in this way. E. W. Brown, Jr., bought an airplane and depreciated it over a seven-year life. However, he only deducted one-half of the annual depreciation on his income tax return each year, because he only claimed to use the plane one-half of the time for business. In the eighth year, he was still using the plane for business and took a further depreciation deduction. Since he had not fully deducted the cost of the plane, this was apparently done on the theory that he could continue to take deductions for business use so long as he had not utilized the full cost of the plane. The IRS, however, had other ideas, and disallowance of the deduction was upheld by a Federal trial court in Texas on the theory that the plane was already fully depreciated, although one-half of its cost had never been deducted.

Postscript

Hopefully, knowledge of the rules and developments reviewed will give readers an idea of other people's experiences in circumstances similar to their own, and of the rules that will apply to them. However, it must be kept in mind that each of these cases and rulings discussed depends on its particular facts, and the result may vary with slightly different facts or with a different judge finding the facts. The most important and valuable use a description of these developments in the law can serve is to give the reader enough knowledge to know when he must go to his tax adviser, and to be aware of facts pertinent to his situation which might be important to his tax adviser. In this way airplane owners and pilots can minimize the tax that they must pay. Application of the rules and developments without such advice can lead to serious errors. □

Enstrom's T-28 Helicopter

■■ The Enstrom Corporation formally presented its new three-place, turbine-powered T-28 helicopter during the recent 1970 Annual Meeting of the Helicopter Association of America (HAA) at Las Vegas. Andreas Aastad, Enstrom vice president of marketing, said the company expected the new ship to be within the reach of many small corporations. The price tag for the T-28, equipped, is quoted at approximately $65,000.

An outgrowth of Enstrom's current model, the piston-powered F-28 helicopter, the T-28 reportedly is the only three-place helicopter to be powered by a turboshaft engine. It uses the TSE36-1 engine manufactured by the Garrett-AiResearch Corporation.

The T-28 has several of the characteristics of its sister ship, according to Enstrom officials. "The high-velocity curve of the T-28 is still well below that of any other three-place machine. The key to the T-28's autorotational characteristics is the sturdy, three-bladed rotor system. Manufactured by Enstrom, the aluminum rotor blades are the only blades certified by the FAA for infinite life."

Basic airframe of the T-28 also is the same as that for the F-28. Performance of the turbine-powered model reportedly has been "significantly improved with several recent modifications." The company listed the improvements as a larger tail rotor to accommodate increased main rotor torque; increased fuel capacity of 72 gallons to extend operating range to 330 miles and maximum endurance to 4.0 hours. Top speed of 129 m.p.h. and cruise speed of 110 m.p.h. are projected certification speeds.

Gross weight for the T-28 is 2,300 pounds, with a useful-load capacity of 1,000 pounds. A new transmission, jointly designed by Enstrom and Buehler Corporation engineers, is rated at 260 input horsepower. The new gearbox "is a simple right angle, ring and pinion gear drive and features forced lubrication. Constructed of lightweight materials, the transmission meets all FAA requirements and is certified for a power rating of 2,900 r.p.m."

Enstrom officials also said they were developing a military version of the T-28 to meet a reported requirement for a small turbine-powered trainer. A military demonstration model, equipped with a complete avionics package, is slated for completion by May. □

Enstrom Corporation's new turbine-powered, three-place T-28 helicopter