Last year brought several new factors of importance to flyers in connection with their Federal income taxes. Investment credit restoration, travel 'away from home' and proficiency flights are discussed by an attorney

TAX Developments Of 1967

by ROBERT I. KELLER

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 and March 1967.)

"The hardest thing in the world to understand is the Income Tax." If these are your sentiments, you are in good company—the words are those of the late Albert Einstein. Upon completing his own tax return, he commented: "This is too difficult for a mathematician. It takes a philosopher."

If Professor Einstein were alive today, he would probably say that it takes a magician rather than a philosopher to understand the complexities of the tax law. Even those who can boast a fair mastery of the subject must admit that certain areas of the law remain somewhat baffling. One such area which is of interest to nearly all flyers relates to the possibility of deducting aircraft operating expenses in connection with training or proficiency flights. As is frequently the case, there is very little in the way of helpful authority to indicate the precise rules to be applied.

One aspect of this area does seem fairly well settled. With very few exceptions, the expenses of first securing a pilot's certificate are considered personal expenses, even if 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. The Tax Court of the United States so held as early as 1947, in the case of *Gibson Products Company, Inc., v. Commissioner of Internal Revenue*, and that court recently reaffirmed its position in the case of *Paul Katz v. Commissioner of Internal Revenue*, decided on Jan. 26, 1968.

In the *Katz* decision the taxpayer, a senior auditor for an accounting firm, occasionally traveled out of town on firm business. As an accommodation to the taxpayer and other employees, the firm allowed them to travel by private aircraft, if work and time schedules permitted, and reimbursed them for travel expenses based on mileage at commercial air rates.

In 1963 the taxpayer deducted $505.90 for flying time and lessons as "educational expenses." The Tax Court, upholding the IRS, disallowed the deduction of these expenses on the ground that they were personal expenses and hence nondeductible. The court noted that the employer never suggested that the taxpayer take the flight instruction; the decision to take the lessons was wholly his own. In fact, the permission to fly his own aircraft on business trips was considered a mere accommodation to the taxpayer. The court concluded that "when all these circumstances are coupled with the evidence of petitioner's life-long interest in flying and his use of private planes for personal and family travel after obtaining his license, we are convinced that his expenditures for flying lessons were not business expenses . . . but were nondeductible personal expenses. . . ."

The Tax Court decision in the *Katz* case by no means answers all of the questions in this area. Expenses of learning to fly are "capital" in nature. That is, they are normally "one time" expenses which, if deductible at all, would not usually be deductible in any single year, but would have to be amortized over the life of the pilot. The IRS maintains that such amortization is not permissible. Although the Tax Court referred to these expenses only as personal expenses and did not discuss their

capital nature, it probably should have classified them, in the language of the Treasury regulations, as an "inseparable combination of personal and capital expenses." Because of the theoretical possibility of amortizing capital expenditures which are nonpersonal, it is quite likely that, within the next few years, questions will arise which will require the courts to be more precise in classifying such items.

On the other hand, deductibility of the costs of postlicensing proficiency flights cannot be denied on the ground that such costs are "capital," since they are of a recurring nature. If these expenses are nondeductible, it must be because they are not "ordinary and necessary" business expenses. (As to the meaning of "ordinary and necessary" in this context, see the tax article in the March 1967 issue of The PILOT.) Where the maintenance of flying skills and/or ratings is required for purely business reasons, as would be the case with a professional pilot, unreimbursed expenses of proficiency flying should be completely deductible.

The noncommercial flyer who uses his aircraft solely for business also has an argument for deducting the expenses of proficiency flights. The problem is that an IRS agent, who is not himself a pilot, may well consider such proficiency flights to be nothing more than personal "joyrides." For example, he would probably be unaware that in certain cases such flights are mandatory before a pilot can fly with passengers. If the agent were made aware of the great importance of such flights, he might then be willing to accept the position that expenses of such flights constitute "ordinary and necessary" business expenses.

If the flyer who uses his aircraft only for business purposes were to prevail on this issue, it would then only be a short step to allowing an allocation of the aircraft operating expenses of proficiency flights to those who use their aircraft only partly for business. In *Hitchcock v. United States*, a United States District Court allocated aircraft expenses between personal and business use by computing the hours flown for each purpose. In each year in question, there was no proof as to the purpose of some of the flight time. The costs of such time were allocated between business and nonbusiness expenses in the same proportion as the other flight hours. Presumably some of the extra hours may have included proficiency flight hours. However, AOPA members should be aware that the court in the *Hitchcock* case never once mentioned proficiency time. The case is therefore no precedent on the issue and an AOPA member who intends to so allocate his expenses might encounter stiff opposition from IRS.

Even if the IRS rejects the allocation described above, the AOPA member might sustain his deduction if he could relate a proficiency flight to a specific business trip. For example, it may be necessary to take a business flight after two months of not flying a certain aircraft. If the pilot takes the aircraft up in order to "get the feel of it" before allowing any passengers to embark, the cost of that flight time could be considered directly related to the business trip and therefore deductible.

However, this area remains a nebulous one. No decisions have come down from the courts and no other direct authority exists for concluding that this expense is or is not deductible. This means that anyone involved with a possible deduction for such flights should relate all the facts of his situation to his tax adviser before taking any steps. It will be a big help if careful records of the purpose of each flight have been kept.

Another area of importance to many AOPA members is the deductibility of the cost of traveling. The courts have, in general, been no kinder to AOPA members in passing on questions concerning the traveling businessman than they were in the area of flying lessons. One exception concerns the treatment for tax purposes of the costs of taking a wife along on a business trip.

The general rule has been and remains that where a taxpayer's wife accompanies him on a business trip, her expenses are not deductible, and any reimbursement of her expenses from the employer is income, unless it can be shown that the wife's presence on the trip had a bona fide business purpose. A wife's performance of some incidental services, such as typing, would not be enough. In effect, the wife has to be an active member of the business, or she must be serving the function of an otherwise required employee.

In 1967, a United States District Court held, in *Roy Disney v. United States*, that the presence of an executive's wife on a business trip did serve a business purpose. Disney is the President of Walt Disney Productions. Because of the company's image as a producer of "family type" entertainment, the court found that "Mrs. Disney's presence on the round-the-world trip and the two trips to Europe served to enhance the firm's image abroad, she assisted her husband in business activities, and her travel was for a bona fide business purpose." The Government has, however, appealed the decision in this case to the Court of Appeals for the Ninth Circuit.

Although it will be the unusual case where an AOPA member can justify his wife's presence on a trip as having a bona fide business purpose, her presence may still be possible at a reduced cost. Assume the price of a single hotel room is $18 and that of a double room $21. It is just the added $3 which is not deductible. Expenses need not be allocated. It is only the amount by which the total expenses are increased because of the wife's presence that is nondeductible. It is, in all likelihood, partly for this reason that commercial airlines offer reduced rates for a wife who accompanies her husband on a weekday flight.

If you intend to deduct your wife's expenses on a business trip, see your tax adviser first. By indicating the presence of your wife to the IRS, you may find them asserting that your trip, which was in fact a genuine business trip, was not for business purposes at all. This could cause you unnecessary time and expenses in justifying your own rightful deduction.

While the AOPA member may now be more successful in deducting his wife's expenses on a business trip, he may find himself less successful in deducting his own, even where his wife does not accompany him, and even where the business nature of the trip is unquestioned.

The Internal Revenue Code allows a deduction for all ordinary and necessary business expenses, which includes "traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business." For many years the courts of the United States have struggled to answer the question, "When is a businessman 'away from home?'" Only if he is "away from home" are amounts paid for his meals and lodging deductible.

The real justification for any such deduction is that the cost of meals and lodging is normally higher away from home than it is at home. In addition, lodging expenses duplicate the rent or other expenses you are already paying on your residence. While theoretically only the additional expenses of meals and lodging away from home should be deductible, the tax law has provided, since 1921, that the entire amount could be deducted if incurred while the taxpayer traveled "away from home." Any other procedure would be overly cumbersome.

IRS initially responded to one aspect of this problem by stating that a person is not "away from home" unless his absence on business is of such a duration that he does not leave from and return to his home the same day. In short, he had to be away overnight. The Service agreed to a slight modification of this rule where, in the words of one court, "the nature of the taxpayer's employment is such that when away from home, during released time, it is reasonable for him to need and obtain sleep or rest in order to meet the exigencies of his employment. . . ." The taxpayer must require this sleep, not voluntarily take it.

In recent years, the courts have expressed growing disagreement with this test. (See The PILOT, March 1967.) The Tax Court of the United States in the 1966 case of *William A. Bagley v. Commissioner of Internal Revenue* announced that "slavish adherence to the 'overnight' rule does not always provide the right answer. . . ." AOPA members would probably favor also the 1966 approach of the Court of Appeals of the Sixth Circuit in *Correll v. United States:* "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 valid regulation under the present statute."

However, on Dec. 11, 1967, the Supreme Court reversed the Sixth Circuit's decision in *Correll v. United States* and upheld the "sleep or rest rule." Basically, the court's feeling was that the abandonment of the "overnight" rule would solve no problems. The Commissioner, the court said, achieved not only "ease and certainty of application" but also "substantial fairness" by stating that unless a trip requires sleep or rest, a taxpayer is not "away from home." The Supreme Court admitted that any rule in this area must, of necessity, make arbitrary distinctions, but felt that this rule was as good as any. But whether the rule is arbitrary or not, a taxpayer can no longer deduct his meals while traveling unless the trip requires him to stop for sleep or rest.

While the "overnight" rule disallows the expenses of short trips, the "temporary" versus "indefinite" rule disallows the expenses of trips of long duration. The IRS has consistently defined "home" as a taxpayer's principal place of business, and has formulated a distinction between "temporary" and "indefinite" assignments. 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 post. But if the assignment is "indefinite" the taxpayer is considered to have brought his "home" with him.

In light of the recent call-up of U.S. Air Force and U.S. Navy reservists, the recent decision of the United States Supreme Court in *Commissioner v. Stidger*, decided March 30, 1967, may be particularly relevant to certain AOPA members. This case arose when Marine Capt. Howe Stidger was assigned to a 15-month tour of duty in the Far East. His wife and two children, who were prohibited from accompanying him, remained in California. While overseas, Capt. Stidger deducted his unreimbursed meal expenses as traveling expenses incurred while "away from home." The court, in reaching its decision on the allowability of this deduction, had to determine where his "home" was.

The Tax Court found that Capt. Stidger's assignment was "indefinite" so that the Far East (and not California) became his "tax home." Accordingly, he was held not to have been traveling "away from home" and his expenses were held not deductible. The Court of Appeals for the Ninth Circuit disagreed, and decided that a taxpayer's "home" does not move with the taxpayer when it is unreasonable or impossible for him to move his family residence to his new place of employment.

Unfortunately, the Supreme Court sided with the Internal Revenue Service and the Tax Court and held that Capt. Stidger's "home" was his duty station in the Far East and his expenses were not deductible.

Nonmilitary AOPA members who may be on assignment away from their normal residence for varying lengths of time should also take note of this case, but should not take the decision in *Stidger* as an insurmountable barrier to deducting expenses while "away from home." The Supreme Court emphasized that it was limiting its decision to a case involving the military. The court believed that other legislation for military men was "designed to provide complete and direct relief from such problems as opposed to the incomplete and indirect relief which an income tax deduction affords to a civilian business traveler." However, the "temporary" versus "indefinite" rule remains the rule that IRS will apply. Therefore, if you are or become involved in a similar situation, be sure to ask your lawyer or accountant where your "home" is.

Although developments in the courts in 1967 adversely affected possible deductions for AOPA members, there is some cause for rejoicing in the action of Congress in restoring the investment credit.

It is important to keep in mind the difference between credits, such as the investment credit, and deductions. While the effect of failing to take an allowable deduction varies with the tax bracket of the taxpayer, an unused credit always has the same effect—each unclaimed dollar of credit is a dollar irrevocably lost. This can be seen by observing the following examples.

(Continued on page 64)

(Continued from page 63)

Assume your 1967 tax return is a separate return with income as below:

Income Subject to Tax	$32,000
Tax Due	$12,210

If you failed to take advantage of a $10,000 deduction, you have suffered an unnecessary cost of $5,180. Your return should have looked like this:

Income Subject to Tax	$22,000
Tax Due	$ 7,030

If, however, you neglected to take a $10,000 credit, 100% of that $10,000 will be lost to you. The amount you owe should be $2,210, not $12,210.

Income Subject to Tax	$32,000
Tax Due	$12,210
Less: Tax Credit	$10,000
Amount Due	$ 2,210

The investment credit is one of the two most important credits for AOPA members. To encourage your investment in a new business aircraft or other new business equipment, the Government, in effect, agrees to subsidize that purchase. Uncle Sam returns to you, in the form of a tax credit, 7% of the purchase price of the equipment, if the equipment has a useful life of more than eight years. Useful life is the period of usefulness to a particular taxpayer, not the maximum period it could be used. If the useful life of the new equipment is between four and eight years, the investment credit is still available in varying percentages.

It was a great blow to businessmen when this credit was suspended on Oct. 10, 1966. (See The PILOT, March 1967.) This suspension, which was scheduled to last 14 months, in fact lasted only five months. In early 1967, President Johnson requested Congress to restore the investment credit. The restoration bill was signed on June 13, 1967, and made retroactive to March 10, 1967.

With the great complexities brought on by the suspension and subsequent restoration of the investment credit, even the "magician" would be hard put to keep track of the changes. Yet, if you do not keep up, you will fail to note a number of new advantages contained in the restoration bill.

Under the legislation imposing the suspension, all property (other than $20,000 of exempt property) ordered during the suspension period would be permanently "tainted." That is, if you ordered a new aircraft for your business on March 1, 1967, you would never be entitled to the investment credit. The restoration bill changes that result. If your aircraft, although ordered during the suspension period, was "acquired" by you after May 24, 1967, it will still qualify for the investment credit. The regulations interpret the term "acquired" to mean property that is "reduced to physical possession or control."

Another investment credit problem particularly pertinent to AOPA members is the availability of this credit upon the purchase of an aircraft used partly for business and partly for pleasure. The most important thing to note is that the amount of credit you are allowed depends on the use to which the aircraft is put in the year it is acquired.

Assume you bought a new aircraft on Jan. 1, 1968, for $50,000, and during 1968 that aircraft is used 60% for business and 40% for pleasure. If that aircraft has a useful life of eight years or more, you will be entitled to an investment credit of 7% of $30,000 (60% of $50,000) or $2,100. If you then use that plane only for business purposes in 1969 and all years thereafter, you will be entitled to no further investment credit. Therefore, if you decide to purchase an aircraft late in 1968, think twice before deciding to "try it out" by flying it across the country on a vacation. That trip may be costing you more than you think.

On the other side of the fence, the Government can demand your return of part of that credit if your percentage of business use is reduced in a year after the acquisition of the aircraft. If, in the above example, your aircraft is used only 40% for business in 1969, you would have to return to the Government $700. You are entitled to a credit of only $1,400 (40% of $50,000 × 7%), not $2,100 (60% of $50,000 × 7%).

Final regulations dealing with the numerous complexities of the investment credit suspension and its restoration are still unavailable. It is therefore imperative, if you purchased, ordered or took delivery of an aircraft or other business equipment during the suspension period, to seek counsel from your tax adviser concerning the availability of the investment credit to you.

The other important credit that flyers should be aware of is the credit for Federal gasoline tax used for nonhighway purposes. In place of the old refund procedure, this credit may now be claimed on Line 19 of your 1967 tax return. This entry on Line 19 must be accompanied by Tax Form 4136 (see The PILOT, March, 1967).

The problems discussed in this article are but a fraction of those the average taxpayer encounters each year. If you experience some frustration while completing your 1967 tax return, you might be comforted in the knowledge that millions of others are having similar problems. U.S. Sen. Warren Magnuson expressed this well when he said: "If Einstein and the agents of the Internal Revenue Service cannot understand the Tax Code, then the ordinary taxpayers of the United States are entitled to a little help." The best overall tax advice that can be given to a taxpayer is that he consult his attorney or accountant in all doubtful cases in order to insure maximum tax savings. □

Traffic Counter Approved For FAAP Planning

Use of the Abrams Air Traffic Counter has burgeoned since its introduction less than two years ago (see August 1966 PILOT) and it has now been approved by FAA to obtain traffic data for Federal Aid to Airports Program planning, according to its makers.

In a recent letter to AOPA, officials of Abrams Instrument Corporation said the battery-operated airport counter is now in use or has been ordered by FAA's Alaskan Region; Michigan, Minnesota, Montana and Idaho Aeronautics Commissions; Riverside County and the Nut Tree Airport in California; and the North Platte, Neb., Airport Authority.

Chester G. Bowers, director of FAA's Airports Service, told the company: "After reviewing the FAA Central Region's test results and analysis of this equipment, we have concluded that the counters will effectively provide counts of operations at nontowered airports provided the sampling techniques utilized are sound and safeguards are employed which prohibit tampering. Under such conditions, we will accept such counts for our national airport planning processes and Federal-aid airport programming."

The Abrams Air Traffic Counter is an electropneumatic device that is powered by two six-volt lantern-type batteries. Designed to operate under all environmental conditions normally found in the United States, it reportedly will give accurate counts on all types of surfaces.

The counter is available in two models, one priced at $515 and the other at $545. The latter includes longer hose lengths and correspondingly greater numbers of clamps and stakes. □

Abrams Air Traffic Counter (lower left), installed here on taxiway at a Michigan airport, reportedly gives accurate tally of a facility's operations to aid in planning and financing purposes. It works equally well on ramp or runway and on virtually all surfaces.