



## Notes From The Washington Counsel

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### Checklist For Tax Deductions

■ ■ It's tax time again and, as is our custom in this column, we will try to provide some helpful information to readers on the deductibility of aircraft operating expenses for federal income tax purposes.

Last year, in the February and March issues of *The PILOT*, we went into some detail on this subject. This year we'll review some general considerations and try to offer a checklist of these deductions. We'll also go over some of the changes in the Revenue Act of 1971 that should be of interest to aircraft owners. For additional details, reprints of last year's articles are available to AOPA members. For definitive answers on your personal tax situation, you should consult your tax advisor.

This information breaks out into two general classifications: first, those deductions that are business-related; and, second, those deductions to which you are entitled whether you use your aircraft for business or not.

**Business Deductions.** It is estimated that most general aviation aircraft are used wholly or partially for business or commercial purposes. So, it becomes important to know if, and to what extent, you are legally entitled to deduct your aircraft operating expenses as business deductions.

**Travel expenses.** The usual form for deducting these expenses is as a business travel deduction. The general rule is that a taxpayer is allowed to deduct all of his *ordinary and necessary* trade or business expenses, including the cost of travel in private aircraft. This is true whether the taxpayer is an employer or employee. The most recurrent problem with the business deductibility of aircraft operating expenses is establishing that these expenses are *ordinary and necessary* to your business or employment. The test comes down to one of reasonableness. Each case is different

and must be decided on the basis of its own set of facts. Business corporations, partnerships and self-employed individuals usually have an easier time than employees in deducting the cost of owning and operating a private aircraft for business travel. Employees have had more serious problems because their cost of operating an aircraft usually has exceeded the cost of travel by other modes, and their employers usually have reimbursed them on the basis of airline fare. The Internal Revenue Service (IRS), in many cases, has taken the position that the excess over the commercial air fare is not *ordinary and necessary* since the employer did not consider it important enough to reimburse for it. However, in other instances, the IRS has been more lenient, primarily in those cases where the taxpayer has been able to show that there is a significant business advantage to him in using private aircraft.

Where all or a portion of the costs of operating a private aircraft are deductible, these costs (such as gas, oil, maintenance, inspection, hangar rent, insurance, etc.) are fairly simple to compute. The aircraft depreciation deduction and the federal investment tax credit are the ones that require more effort.

**Investment credit.** The investment credit has been revived by the Revenue Act of 1971 [Nov. 1971 *PILOT*, page 8]. It's now called the "Job Development Investment Credit." This is a credit against the federal income tax. It amounts to 7% of a qualified investment in certain depreciable personal property acquired after Aug. 15, 1971, (or acquired after March 31, 1971, and before Aug. 15, 1971, but which was ordered after March 31, 1971). This credit was originally introduced in 1962, suspended for a time during 1966 and 1967, and repealed generally after April 18, 1969.

Investment in new and used aircraft and aviation equipment acquired for use in business qualifies for the credit. The amount that qualifies for credit is the basis (usually cost) of new property, and up to \$50,000 of the cost of used property. If the property has a useful life of less than seven years but at least five (and most aircraft fit here), only two-thirds of the basis or cost is taken into account. Only one-third is taken into account where the useful life is at least three and less than five years. No credit is allowed if the useful life is less than three years.

There is a maximum credit allowable. The investment tax credit may not exceed your tax liability, and if your tax liability exceeds \$25,000, the tax credit may not exceed \$25,000 plus 50% of the tax liability over the amount. There are also limitations on carryovers and carrybacks.

The investment credit must be claimed on IRS Form 3468.

**Depreciation.** Another new feature introduced by the Revenue Act of 1971 is the "class life" system of depreciation. You now have two options for computing depreciation for assets placed in service after 1970: (1) to use the new class life system; or (2) to follow the general rules using estimated useful life as described in last year's February and March PILOT articles. A full explanation of this new system would require too much space and cannot be provided in this article. Suffice it to say that the new system is of benefit to taxpayers who might have many depreciable assets. Its basic purpose is to keep conflict with IRS over the individual useful life of equipment at a minimum.

**Business entertainment.** Subject to certain conditions, the costs of operating an aircraft may be deducted if the aircraft is used for business entertainment.

**Educational expenses.** Aviation education expenses are deductible if the education: (1) maintains or improves skills required by the individual in his employment, trade or business; or (2) meets the express requirements of his employer, or the requirements of applicable laws or regulations, imposed as a condition to the individual's retention of his salary, status or employment. Educational expenses are not deductible if incurred to meet the minimum educational requirements for qualification in taxpayer's present employment, trade or business, or if taken to qualify the individual for a new trade or business.

**Nonbusiness deductions.** With respect to nonbusiness deductions, here is a checklist:

**Interest.** The interest you pay on your aircraft, or equipment, loan is deductible, as is any other interest you pay. If you have prepaid your loan during the year, chances are you had to pay a penalty. Penalty payments are also deductible as interest.

**Casualty losses.** If you itemize your deductions, you can deduct any casualty

losses to your aircraft or its equipment that are not compensated for by insurance or otherwise. The deduction is limited to each loss in excess of \$100. This would cover any property damage to the aircraft caused by an accident, but it would not include any damage due to rusting, corrosion or other natural deterioration of the aircraft, nor engine damage or engine failure due to normal wear and tear.

You are entitled to deduct any unreimbursed losses from theft.

**Personal property taxes.** Any property taxes you pay to a state or locality on your aircraft are fully deductible for federal income tax purposes. If it is a personal property tax, there is no question about it. However, there is some question on state aircraft licensing fees that are imposed in lieu of the personal property tax. Many states have such a fee arrangement, and these arrangements do raise a question as to whether such fees are deductible as personal property taxes. In my judgment, they are deductible because they are expressly in place of the personal property tax. But, the IRS has not formally ruled on this point.

**Sales tax.** Any retail sales tax on the purchase of any aircraft or any equipment, whether imposed by a state, city, or locality, is deductible. Instead of trying to compute all of the sales tax we paid during the year, many of us use the schedule of standard sales tax deductions contained in the official instructions for IRS Form 1040. The question is, can you add the sales tax on an aircraft or expensive aircraft component to the amount allowed in the schedule? I think you can. This is because IRS allows you to add the sales tax on the purchase of an automobile. The same treatment should be accorded to an aircraft purchase.

**State fuel tax.** You can deduct all of the amounts you have paid to any state or locality for aviation fuel taxes. However, you cannot deduct any portion of these taxes that is refunded to you, as is done in some states [Sept. 1971 PILOT, page 92].

**Federal oil tax credit.** We are no longer able to take a tax credit for the amounts we have paid to the federal government for gasoline taxes. But we remain entitled to take a credit of \$.06 per gallon on aviation lubricating oil. Where most of us are concerned, the amount of this credit would be so insignificant as not to warrant its claim. But there are some who use enough lubricating oil to make the credit important. In order to claim an oil tax credit, you must submit an IRS Form 4136.

One final thought—while it is your moral and legal duty to pay your taxes, it is not your moral or legal duty to *overpay* them. It is perfectly proper for you to ensure that you are taking all of the deductions to which you are entitled. □