

* The author, a member of the Philadelphia law firm of Wolf, Block, Schorr and Solis-Cohen, wishes to acknowledge the assistance of his partners and particularly of his associate, Charles G. Kopp, in the preparation of this article, which is intended to update income tax information published in *The PILOT* of March 1958 and January and March, 1959. The author's "Legally Speaking" column appears each month in *The PILOT*.

You may find it hard to believe, but the manner in which you fill out your Federal and state income tax forms may very well determine whether your flying is a luxury or an economical means of transportation. The cost of flying your own airplane can be reduced considerably by taking advantage of many legitimate income tax deductions.

This does not mean that you must resort to morally questionable practices around April 15; it simply means that you should take advantage of all the tax savings which the law rightfully allows you as an airplane owner or operator. There is nothing wrong, either legally or ethically, in taking all the deductions to which you are entitled. Intelligent legal activity becomes more and more important as your earnings increase above \$5,000 a year.

What are some of the proper avenues which exist for tax savings? The Federal Internal Revenue Service has now generally accepted the premise that expenses incident to the use of an airplane for business transportation should not be any less deductible than the costs of an automobile used for the same purpose.

In 1957, the Aircraft Owners and Pilots Association participated in the effort of one of its members to convince an IRS field representative that, for tax purposes, a taxpayer is not required to use the cheapest mode of transportation when he travels between two points on business. The AOPA member with whom AOPA joined was, along with several other traveling representatives of a national organization, given an automobile allowance of eight cents a mile. Rather than use an automobile, however, the AOPAer elected to use his airplane. He had to bear all direct and indirect expenses of operating the Cessna 140 out of his mileage allowance. The IRS took the position that the extra expenses incurred in flying were not deductible by the AOPA member. The agent insisted that the representative should have used an automobile "just like the other representatives."

Tax Savings And Flying

*Reduce your aircraft expenses
by taking advantage
of legitimate deductions*

by ALFRED L. WOLF* • AOPA 5
AOPA General Counsel

AOPA, of course, took a dim view of the Federal agent's interpretation of the tax laws. Its stock of material showing that travel by private airplane often was more economical in the long run than other means of transportation was sent to the member. He also received a copy of an AOPA Special Report, entitled "Tax Savings for Pilots and Owners," which was being distributed at that time. [This article supersedes the Special Report.—Ed.]

About a month later the AOPA member wrote that AOPA probably would be interested in knowing that with the information it had sent out, he had been able to "settle his troubles" with the Treasury Department. When all of the facts were explored, it turned out that the Government owed the member rather than the

member being in arrears to the Government. The member and the Government called it a draw, however, in order to bring about a quick settlement.

There are certain basic deductions which are available to all aircraft owners (as well as other taxpayers) whether or not their aircraft is used to any degree for business purposes. If the airplane is used in business, even on a part time basis, the possibilities for legitimate deductions are, of course, sharply increased.

Nonbusiness deductions are available only if the standard deduction is not used. The standard deduction for married persons whose adjusted gross income is at least \$5,000 is 10% of such adjusted gross income; but the deduction cannot exceed \$500 if an individual return is used or \$1,000 if a joint return is filed. A single person whose adjusted gross income is \$5,000 or more is entitled to a deduction of 10% of adjusted gross income or \$1,000, whichever is the lesser. If an individual's adjusted gross income is less than \$5,000, the standard deduction is 10%.

If your deductions exceed the standard allowance, you should itemize them. In the case of many aircraft owners, it is clearly advantageous to itemize deductions. For example, if you borrowed money to purchase your plane, the interest you pay on the loan is deductible, whether or not the aircraft is used for business. State aircraft and pilot license fees also appear to be deductible.

Any losses or damage to aircraft, not compensated by insurance, due to fire, theft or casualty would also be deductible. This includes losses or damage to your aircraft in flight which are not due to your willful act or negligence.

Expenses incurred by Civil Defense volunteers in the performance of their volunteer duties, such as the expenses of attending state meetings or other expenses attributable to the rendition of such volunteer services, have been ruled deductible contributions. This should be of interest to most volunteer personnel in defense activities.

Also, it has recently been held that unreimbursed out-of-pocket expenses incurred in the operation, maintenance and repair of a personally owned aircraft, automobile and communication system are deductible as contributions when such expenses are directly attributable to the performance of Civil Air Patrol volunteer services.

Expenses similarly incurred for the purchase and maintenance of distinctive uniforms required to be worn

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Tax Savings

(Continued from page 28)

while engaged in official Civil Air Patrol activities are likewise deductible as contributions. Only those expenditures which are directly attributable to performing gratuitous services for the CAP are deductible, however, and no deduction is allowed for a proportionate share of the expenses incurred in the general maintenance of the aircraft, automobile or communication system.

Occasionally, an AOPA member writes that he learned to fly so that he could use his own airplane, or one owned by his employer, in conducting his normal business activities. "Can I deduct the cost of this training?" he asks. A deduction of this sort is not allowed, however, any more than the cost of learning to drive an automobile is deductible. A professional pilot, on the other hand, who pays for additional training required by his employer can properly deduct his training costs.

When your plane is used solely for business, all your expenses relating to the aircraft are deductible, even if the standard deduction is used. If the aircraft is used both for business and pleasure, that portion of the expense which can be attributed to the business use of the plane is deductible.

Other than the important item of depreciation, there are several things you should watch particularly if your plane is used in business.

1. If you hire a pilot and any other

crewman to fly your plane, their salaries would be deductible.

2. Hangar rental or any other cost connected with storing, maintaining or parking your plane would be deductible.

3. Your total gasoline and oil cost would be deductible. Of course, if you deduct the total cost of oil and gasoline, you cannot take a separate, additional deduction for state and Federal gasoline taxes you may pay. If you obtain Federal or state refunds on the gasoline taxes you pay, the refunded amount cannot be included in your cost.

4. The premiums for insurance that you carry on your airplane would also be deductible as a business expense.

5. Any judgments you were forced to pay due to your negligence in flying would be deductible.

6. If you suffer a loss when you sell your airplane, such loss is deductible.

7. Cost of all repairs made on your airplane during the tax year would be deductible; cost of additional tires, if used for less than one year, also would be deductible as repairs. If the tires had a greater life you would then deduct depreciation over the life of the tires rather than take the full amount in one year.

8. When your plane is used for business activities only a part of the time, you should carefully compute the exact percentage of time that it is used for business transportation. That percentage would then apply to the items normally deductible as a business expense.

Now for the depreciation item which is extremely important in reducing the

cost of business flying:

When your aircraft is used in trade or business, a depreciation deduction is allowed to the extent of that use. This means that if one-half of your airplane mileage is for business purposes and the other half is for pleasure flying, then one-half of the regular depreciation allowance may be deducted on your Federal tax return.

Generally, the purpose of the depreciation deduction is to permit the taxpayer to write off the cost of his property over the estimated useful life of the property. The key question, therefore, is: What constitutes the useful life of an airplane for this tax purpose?

Taxing authorities consider that a five-year life for aircraft is reasonable. This official position was taken in an IRS publication known as "Bulletin F," and litigation of this issue generally confirms the reasonableness of the five-year period. However, in one case there was agreement between the Commissioner of Internal Revenue and the taxpayer during the course of the trial that four years would be a reasonable life expectancy for an airplane. The court approved the agreement.

The result of all this is that the taxpayer is on safe ground when he claims a five-year useful life for his aircraft. He even has some authority for claiming a four-year useful life. Therefore, the taxpayer normally may write off the cost of his aircraft used in business at the rate of 20% per year. He might even be able to write off the cost in four years.

The tax law allows an even more favorable depreciation allowance in certain special cases. It applies only to new aircraft purchased on or after Jan. 1, 1954. If you have bought a new plane since that date you can take advantage of what the Internal Revenue Code describes as the "declining balance" method of depreciation. This method allows you, in the first year, to write off the cost of your airplane at 200% of the "straight line" rate. The "straight line" rate is the normal method used when the taxpayer writes off the cost of his airplane by taking equal amounts each year as a deduction for depreciation.

Here is how the "declining balance" method would work on a new \$10,000 airplane with a useful life of five years:

	Remaining Basis	Declining Balance Rate	Depreciation Allowance
1st year	\$10,000	40%	\$4,000
2nd year	6,000	40%	2,400
3rd year	3,600	40%	1,440
4th year	2,160	40%	864
5th year	1,296	40%	518.40

While salvage is not taken into account in determining the annual allowances under this method, in no event can an asset be depreciated below a reasonable salvage value.

The effect of this provision is to permit you to write off approximately two-thirds of the cost of new planes and equipment over a period equal to one-half of their useful lives. This method



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permits a depreciation deduction of twice the "straight line" rate in the first year after the aircraft is purchased. This offers an obvious tax advantage to many taxpayers.

The law also allows the "sum of the years-digits method" for new airplanes bought after Dec. 31, 1953. In many cases, this method will be even more advantageous to the taxpayer than the "declining balance" method.

The "sum of the years-digits" method of depreciation for an aircraft having a useful life of five years and a remaining cost basis of \$10,000 after deducting a reasonable salvage value from original cost works as follows:

	Rate of Depreciation	Depreciation Allowance
1st year	5/15ths	\$3,333.34
2nd year	4/15ths	2,666.67
3rd year	3/15ths	2,000.00
4th year	2/15ths	1,333.33
5th year	1/15th	666.66

This listing and the treatment of depreciation is by no means exhaustive. Information given in this article should be used only as a general guide. Your accountant and attorney will be helpful allies in applying these principles to the facts of your case, as well as suggesting other avenues of tax savings.

Aside from strictly aviation tax savings, you should give careful attention to all of your claimed deductions for transportation, travel and other expense account items. The IRS has indicated a tightening up of its requirements for reporting these items.

You will note that in your 1960 tax return [Form 1040—Schedule C] there is a new section entitled "Expense Account Information." It is extremely important, therefore, to keep detailed records of all expense items.

Where the employee is required to, and does, "account" to his employer, the regulations provide for the following treatment of business expenses: (1) Where the total amount of reimbursements, advances, and expenses charged directly or indirectly to the employer (through credit cards, etc.) is equal to the total amount of ordinary and necessary business expenses paid or incurred by the employee, the employee need not report in his tax return the amount of his business expenses or reimbursements. The employee need only state in his return that the total of amounts charged directly or indirectly to his employer and received from his employer as advances or reimbursements did not exceed the ordinary and necessary business expenses paid or incurred by such employee. (2) Where the reimbursements, advances and direct and indirect charges to the employer exceed the employee's business expenses paid or incurred, the excess amount must be included in the income of the employee. The amount is shown on the tax return (Form 1040) on line 5, page 1 as "Excess Reimbursements." Again, total expenses and reimbursements need not be reported; only the excess of reimbursement over expense. (3) Where the employee's business ex-

penses paid or incurred exceed the reimbursements, advances, and direct and indirect charges to the employer, the employee may secure a deduction for the excess if he submits a statement showing the following information as part of his tax return:

(a) The total of all amounts charged to and received from the employer in connection with the ordinary and necessary business expenses of the employee;

(b) The total amount of ordinary and necessary business expenses paid or incurred by the employee (including those charged directly or indirectly to the employer) broken down into such broad categories as transportation, entertainment expenses, meals and lodgings while away from home overnight, and other business expenses;

(c) The nature of the employee's occupation, and the number of days away from home.

To "account" to his employer, as used in the regulations, means to submit an expense account or other required writ-

ten statement to the employer showing the business nature and amount of all the employee's expenses. The business expenses reported to the employer should be broken down into broad categories such as transportation, meals and lodgings while away from home overnight, entertainment expenses, and other business expenses. If the employee is required to, and does in fact, "account" to his employer, he should check the two boxes on page 1 of Form 1040 indicating that he has received an expense allowance for which he has submitted an itemized accounting to his employer. Where the employee is not required to "account" to his employer for his ordinary and necessary business expenses, or though required, fails to so "account," he must submit a statement showing the following information as part of his tax return:

(1) The total of all amounts charged to and received from his employer in connection with the ordinary and necessary business expenses of the employee;

(2) The total amount of ordinary and necessary business expenses paid or incurred by the employee (including those charged directly or indirectly to the employer) broken down into such broad categories as transportation, meals and lodging while away from home overnight, entertainment expenses, and other business expenses;

(3) The nature of the employee's occupation and the number of days away from home on business.

The employee should submit the above information in a statement attached to his return, answer the questions on page 1 of Form 1040 relating to reimbursed expenses and complete his return as follows:

(a) If the employer's payments equaled the employee's business expenses, no further entry need be made on the tax return since the amounts cancel each other.

(b) If the employer's payments exceeded the employee's business expenses, the excess amount should be included in income on line 5, page 1 of Form 1040 and identified as "Excess Reimbursements."

(c) If the employee's business expenses exceeded the employer's payments, the employee may claim a deduction for the excess. This deduction will appear on the tax return (Form 1040) either on line 5, page 1 or on page 2, "Other Deductions," depending on the nature of the business expenses being deducted.

An official worksheet [IRS Form 2106] is available at local tax offices to aid the taxpayer in calculating transportation expenses, travel expenses away from home and reimbursed business expenses. This form may be, but is not required to be, attached to the return.

Although most of the flyer's attention will be centered on his income tax return, he should not lose sight of the fact that substantial savings are also possible if he applies for all of the gasoline tax refunds to which he is entitled. Two cents of the four cents per gallon Federal gasoline tax is refundable to nonhighway consumers. [For gasoline purchased before Oct. 1, 1959, the refund would be one cent of every three cents paid; the four cent gas tax rate is effective from Oct. 1, 1959 through June 30, 1961.] Many of the states also allow refunds paid on gasoline used in aircraft. You should investigate the situation in the states where you make your major purchases. The AOPA PILOT Special Report "Tax Refunds On Aviation Gasoline" [Jan. 1960 PILOT] may be of assistance to you in this matter. The report lists the gasoline tax and the refunds allowed in each state. It also explains how refund applications should be filed.

All in all, therefore, it is clear that there are legitimate ways in which the cost of flying can be reduced by taking advantage of proper income tax deductions. You should consult your attorney in all doubtful cases in order to best insure maximum tax savings. Indeed, tax savings and flying are closely related.

END

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