Tax Savings For Flyers: Part I

A review of the usual credits and deductions available to aircraft owners whether or not they are business-related. March installment of this two-part series will discuss business-related tax deductions

■■ It's tax time again. And every year about this time we try to provide our members with information helpful to them in the preparation of their Federal income tax returns. These comments are necessarily general and deal with the more typical situations. You should consult your attorney or tax advisor about any questions on your particular situation.

In this article we will deal with the usual credits and deductions available to aircraft owners whether or not they are business-related. Next month we will talk about business-related tax deductions.

Federal Gas and Oil Tax Credit

The Federal gas-tax credit has been partially eliminated for last year and fully eliminated for future years. You may recall that for the past several years, an aircraft owner has been able to take a credit on his Federal income tax return of two cents for each gallon of gasoline used in his aircraft during the taxable year. He has also been entitled to a credit of six cents per gallon on aviation lubricating oil. The gasoline tax credit has been eliminated as of July 1, 1970, by the Airport and Airway Revenue Act of 1970. This is the so-called "user-charge" legislation which imposes a seven-cents-a-gallon gasoline tax on noncommercial aviation. Because of the mid-1970 effective date of this legislation, a credit is still available for the months January through June of 1970. Taxpayers on a calendar year basis are entitled to a credit for gasoline used in these first six months of 1970. The lubricating oil tax credit was unaffected by the user-charge legislation and remains available for the full year. In order to claim the gas and oil tax credit, Internal Revenue requires that you complete and attach Form 4136 to your return to support the credit taken.

State Fuel Tax

In addition to the Federal fuel taxes, many states and localities also impose aviation fuel taxes. To the extent that these taxes are not refunded to you, you can deduct them. Notice that the state fuel taxes are a deduction, not a credit as in the Federal fuel tax situation. A credit is more advantageous than a deduction since the credit directly reduces your tax, dollar for dollar, whereas a deduction only reduces the amount on which the tax is computed. Notice, for example, an individual filing Form 1040 would take the credit on line 63, Part VII of the form "Credit for Federal tax on gasoline, special fuels, and lubricating oil." The state or local fuel tax deduction would be taken on the line "State and local gasoline" on Schedule A of the form.

Sales Tax

Any retail sales tax on the purchase of an aircraft or any equipment, whether imposed by a state or a city, is deductible. Many taxpayers who itemize their deductions, utilize the published schedule of standard sales tax deductions contained in the official instructions for Form 1040. These schedules are graduated according to income and family size. A deduction based on the schedule will normally be accepted without question. A taxpayer who claims a deduction in excess of the amount indicated in the schedule may be required to substantiate his entire deduction. If you purchase an airplane or any expensive aeronautical equipment during the year, chances are your total sales tax payments exceed the amount allowed in the schedule. The question is, can you add the sales tax on these expensive items to the amount allowed in the schedule. The purchase of an automobile is one item that can be added to the schedule amount without triggering the necessity of substantiating all of your sales tax payments for the year—only the tax on the automobile need be substantiated. The reasons for according the automobile sales tax transaction special treatment would seem to also apply to the aircraft sales tax transaction. In a few cases of which we are aware, IRS has allowed the sales tax on an aircraft to be added to the schedule amount, and we believe properly so.

You don't have to use the schedule. You can always deduct the *actual* total sales tax you paid during the year. But, if you don't use the schedule, you must be able to substantiate the amount of sales tax paid. This is usually a difficult task because of the numerous taxable sales transactions which occur during a year.

Personal Property Tax and Aircraft Licensing Fees

Some states and localities impose a personal property tax on aircraft. All property taxes are deductible by the person against whom imposed—that is, the person against whom assessed. So, an aircraft property tax is deductible.

A difficult question arises with respect to state aircraft licensing fees, particularly in those states where the fees are imposed in lieu of the personal property tax. A licensing fee, as such, is not deductible unless it can be considered to be a personal property tax. In order for it to be considered to be a personal property tax, the fee must be *ad valorem,* that is, the fee must be substantially in proportion to the value of the aircraft. A fee based on aircraft weight, or horsepower, or passenger seats, would probably not be considered *ad valorem.* A fee based on the value of the aircraft would be deductible.

It is my personal view that an aircraft licensing fee which is in lieu of personal property tax should be deductible as a personal property tax. But so far we haven't had an IRS ruling on it.

Many of our members have raised a question about the deductibility of the new Federal use tax ($25 plus $.02 per pound for piston aircraft over 2,500 pounds and $.03½ per pound for tur-

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by JOHN S. YODICE/ AOPA 199738

bine-powered aircraft). It's painfully clear that the Federal use tax on aircraft is not deductible.

Casualty Losses

If you itemize your deductions, you can deduct your losses of nonbusiness and non-income-producing property sustained during the taxable year which are not compensated for by insurance or otherwise, if the loss arises from "fire, storm, shipwreck, or other casualty, or from theft." The deduction is limited to the amount of each loss in excess of $100. The terms "fire," "storm," "shipwreck," and "theft" are specific enough not to raise many questions. The questions presented usually involve the meaning of the term "other casualty." Almost certainly, any unreimbursed property damage arising from an aircraft accident is deductible. If it's not specifically a "shipwreck," certainly it is of a sufficiently similar character to be classified as an "other casualty." Similar losses occasioned by natural or other external forces in an event due to some sudden, unexpected or unusual cause, are deductible. But IRS draws the line at losses reflecting a steady deterioration, or caused by other than external forces. Rusting, corrosion or other natural deterioration of an aircraft are not casualty losses; nor is engine damage or failure due to normal wear and tear.

All unreimbursed thefts of aircraft and aircraft equipment (and there have been some) are deductible.

Interest

The interest you pay on your aircraft or equipment loan is deductible, as is any interest you pay. The problem many times encountered is determining the amount of the deduction. Most of us make monthly payments which do not vary in amount from month to month. So the amount of interest paid each month varies from month to month because the unpaid balance is continually declining. Unless your bank or finance company advises you how much you paid in interest during the taxable year, you must compute the amount. One simple method is to determine the total interest payable on the note, then divide that amount by the total number of monthly payments. This gives you an average monthly interest payment. Your deduction would be this amount times the number of monthly payments paid during the taxable year. This method does not determine exactly what you paid in interest during the year, but if you use the method consistently over the life of the loan, you will get all of the interest deduction to which you are entitled. There are more precise, and more complicated, methods for computing your interest deduction. Your tax advisor can assist you in determining which to use.

Here's a deduction lots of people miss. If you have prepaid your aircraft loan during the taxable year, chances are you had to pay a penalty. These penalty payments are also deductible as interest. □

(*Next month: business-related tax deductions.*)