

## **Ordinary and Necessary Expenses in Business Use of Aircraft**

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One of the biggest areas of tax litigation for aircraft owners involves Section 162 of the IRS Code concerning the deductibility of ordinary and necessary business expenses. An ordinary expense is one that is normally to be expected, in view of the circumstances facing the business. Necessary has been interpreted to mean appropriate and helpful in the development of the taxpayers business. And for expenses to be deductible they must be associated with the taxpayers trade or business activities rather than with hobbies. For example, if you have a hobby interest in stamp or coin collecting, using your aircraft to attend auctions would not be considered a business use of the plane.

During a routine audit, the IRS will likely look at the airplane expenses and try and argue that the expenses were not ordinary and necessary business expenses. With business use of private aircraft, there are several key issues that the IRS or the Tax Court will want to determine:

1. Is the airplane useful in the operation of your business, for example, is its use instrumental in helping to obtain new clients or customers, or is it helpful in enabling other employees to visit several cities in one day to conduct business, and return home?
2. Is the airplane used exclusively, or nearly so, for business purposes?
3. Did the taxpayer determine that there were less frequent commercial flights to cover the region where it is necessary to travel? If so, this is evidence that it is necessary to use the private airplane to maximize your efficiency and save time.
4. By using the airplane, are you able to arrange a more flexible schedule which enables you to reach customers or locations where business is conducted in an expeditious manner?
5. To what extent is the airplane used to entertain clients, such as taking them on scenic flights or fishing trips? If there is too much use for entertainment purposes, this will work against the taxpayer. Entertainment expenses need to comply with substantiation requirements under IRS Code section 274(d). That section provides that no deduction may be allowed for travel, entertainment, or gift expenses unless you substantiate by adequate records the amount, time, place, business purpose of the expenses and the business relationship to you of the persons entertained. Your records should reflect that business was discussed with your clients during these trips. The predominant purpose of the trips should be to further your business. (In this regard, it has been held that the mere generating of goodwill is not a sufficient business purpose to justify entertainment expenses.) Absent adequate records, you may establish a business purpose by other evidence, including your own statement together with other corroborating evidence, but the IRS will often reject otherwise bona fide entertainment deductions if the only evidence is the taxpayer's self-serving statement.

6. Does the taxpayer maintain an adequate flight log showing the origin, destination, date and travel time for each of the business flights?

7. Are the expenses claimed for airplane usage reasonable in amount? The business expense must be reasonable in amount relative to its purpose in order to be deductible.

8. If the plane is chartered at an hourly rate, and held on a 24-hour standby basis, is there justification for maintaining it on a permanent standby basis?

If you are audited by the IRS, the above issues will need to be met, primarily by documentary evidence. Is you are adequately prepared in substantiating the items mentioned above, you may well be successful in withstanding IRS scrutiny.