

## **Recent Boat Chartering Case**

By John Alan Cohan, Attorney at Law

A recent Tax Court decision came down against a correctional officer and his wife, a high school dance teacher, who were held not to be engaged in a boat chartering activity for profit. The case involved Herbert and Paula Meeks of Sacramento, California.

If you use your boat for chartering and for pleasure you are entitled to some tax benefits, but in their case they lost because there was no “business plan,” and prior to entering into the activity they didn’t conduct any market analysis. Also, they didn’t keep proper books and records of their chartering business. The Tax Court therefore found that the elements of personal pleasure and recreation outweighed any profit motives in their chartering activity, and denied their deductions.

Tax Court cases involving boat owners have consistently held that in order to qualify a chartering activity as a business, and therefore deduct costs and depreciation associated with your boat, you must show an actual and honest objective in making a profit. You might not have any profit years, but if you are audited by the IRS you will need to have a paper trail of evidence that will show an actual and honest intention to be engaged in a business, not a hobby. Based on my analysis of the leading Tax Court cases on this subject, here are the main criteria which--ideally speaking--a boat owner should meet in order to show a profit motive and withstand IRS scrutiny:

1. You should conduct preliminary investigations such as consulting professionals (charter operators, a charter captain, and charter agents) about the profitability of engaging in chartering. Also, you should study boating and investment periodicals, analyze information about operating costs, and find out what licensing requirements there are for operating a charter vessel. Attend seminars on operating a chartering business. The failure to seek professional advice indicates a lack of profit motive.
2. It’s good to show that while you have no prior experience with chartering, you are an experienced sailor.
3. You can’t simply assume that charterers will be forthcoming. The activity must be operated in a businesslike manner, with a credible business or profit plan with simple financial projections. Present it to an accountant to see if there are any flaws in your strategy. You don’t need to have a sophisticated cost accounting system, profit or loss statements, balance sheets or break-even analyses.
4. It’s important to keep accurate books and records, and to show the amount of time you devote to the charter activity. There should be a separate checking account and no commingling of funds with other activities. The vessel should be insured as a charter boat.

5. There should be advertising activities--not just flyers posted around town and in bait shops, or announcements in your church bulletin, but paid advertising in boat magazines and trade journals. Give talks at boat shows, promote your charter with charter agents and sailing clubs and, nowadays, it's impressive to establish a professionally designed Web site.
6. It's important to show that you have attempted to change the manner of operating the business--by reducing charter fees, for instance--in order to try and attract more business, or some other change to reduce costs such as doing your own paperwork, or performing some of the maintenance and repair work yourself.
7. It is useful to show that you acquired the vessel with the expectation that it would appreciate in value, and that you believed this would help offset early losses.
8. The mere fact that you derive personal pleasure from conducting the activity does not, per se, show a lack of profit motive. But if you make substantial personal use of the yacht on weekends, for instance, this is a red flag to the IRS unless the other elements are strongly in place.