

Summary of Interesting Tax Cases

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Some accountant friends asked if I could write about cases I am familiar with that involve pilots who have either been granted or denied tax deductions in connection with various aircraft activities. Most of these involve charter and rental activities, and so I will share them with you. Mind you, these cases are all from the Tax Court or federal courts after the IRS issued a deficiency notice.

In an interesting case dealing with tax issues and flying, an airplane pilot was denied tax deductions for his stunt flying activity. He had operated the stunt plane in order to perform in air shows and instruct students in aerial aerobatics. The court said that he did not have the requisite profit motive for the years in question, although he was allowed deductions for an earlier year. The taxpayer admitted that he let the business go, and spent little or nothing on advertising and upkeep of the plane. *G.R. Kartrude, Jr. v. I.R.S.*, 925 F.2d 1379 (11th Cir. 1991).

An important case involved an executive who had an honest profit objective in purchasing a BAC 1-11 aircraft and was entitled to loss deductions in connection with his aircraft leasing activities. He was a successful businessman, he acquired a small fleet which he used in the business, and also hired out for charter. He also used a firm that provided maintenance and charter services, and the aircraft did in fact generate some charter revenues. *B. Cornfield v. I.R.S.*, 797 F.2d 1049 (D.C. Cir.). However, in other cases, leasing activities were held to be not engaged in for profit, and expenses that exceeded the income were disallowed because no profit motive existed. See, e.g., *C.M. Worley*, 39 TCM 1090.

Another case against the taxpayer involved someone who derived a great deal of personal pleasure and recreation from flying his plane, so that the IRS found the rental activity was simply a means of subsidizing what was basically a personal expense. *L.W. Mueller*, 50 TCM 1548. Another case against the taxpayer involved a pilot who depended on word-of-mouth referrals and a sign posted in the planes window to generate business, of which there was little. The pilot failed to produce logbooks or other evidence of the time and effort expended in the activity. The IRS held the airplane operations were nondeductible personal expenses. *B.L. Swicegood*, 57 TCM 1456.

In an important case involving taxpayers who purchased aircraft to operate as a charter business, they won. The case turned on the fact that the aircraft was used almost exclusively for business purposes even though the primary lessee was a related joint venture of the taxpayers. *G.E. Louismet*, 43 TCM 1496.

One lesson observed from many of the cases is that in situations where people claim to be using their aircraft in a charter activity, it is important to have much more evidence than simply uncorroborated, self-serving testimony. See, e.g., *D.R. Bacot*, 56 TCM 1322.

Another charter case that held in favor of the taxpayer involved the purchase of a cargo

plane that was intended to be leased to an airplane charter service. The taxpayer relied on a pilot's advice and expertise in entering the leasing business, but losses accrued. The losses were primarily because of the unforeseen death of the pilot and the resulting demise of the charter business. The court found that because the plane was noisy, fuel inefficient, difficult to fly and suited for cargo proved that it was not purchased for personal use. *J.D. Williams*, 53 TCM 1203. Another case involved a pilot who had an honest profit objective in his aircraft leasing business and was entitled to deduct his expenses related to that activity. *R.B. Keenan*, 57 TCM 762.

An interesting case involved an engineer who developed and sold a modification kit for Navio aircraft. The court found the activity was carried on for personal enjoyment, and he could not deduct losses claimed in connection with it. There was no meaningful market survey, he spent only a limited amount of time on the venture, and experienced a sustained period of losses. In addition, the kit was never approved by the FAA for use or sale. *W.L. Marcy*, 68 TCM 1028.

In another case, the taxpayer sought to justify the deductions from his aircraft rental business based in part on the theory that the aircraft was appreciating in value. However, he did not conduct the operations in a businesslike manner, he did not acquire expertise in the area, and he did not devote very much time to the activity. *R.E. Wesinger, Jr.*, 78 TCM 771.

A pilot was not allowed to deduct losses related to his purchase and the building and improving of aircraft because the court found the activity to be a hobby. He incurred substantial losses that he used to offset his significant pilot wages. He had no business plan, and maintained insufficient records. *J.G. Parker*, 83 TCM 1400.

Another taxpayer used his aircraft to transport individuals to a lakefront lodge property that he owned. There were only isolated situations of profit-seeking ventures, and his deductions were disallowed. *L.T. Baldwin*, 83 TCM 1915.

These cases were in the U.S. Tax Court or in the Court of Appeals. Generally, the judges commented that the taxpayers lost primarily because they failed to provide an adequate paper trail to support their argument that the activity was engaged in for profit. Documentary evidence that could be helpful includes, in addition to logs of time expended, tax opinion advice from legal counsel, proof of a marketing plan, proof of advertising, and other helpful backup material.