



## **AIRCRAFT TAX DEDUCTIONS NEED NOT RESULT IN AUTOMATIC IRS EXAMS**

### **ALL DEDUCTIONS PLAY A FACTOR, BUT THERE IS NOTHING SPECIAL ABOUT AIRCRAFT**

We often encounter taxpayers who believe that if they take allowable deductions for aircraft expenses they will greatly increase their chances for an IRS examination. We find that position is totally without merit. The actual scoring process used to select returns for examination is a closely-guarded national secret, and the courts have consistently upheld the IRS' right to protect it. However, it does not appear that the Service is subjecting aircraft operators to special scrutiny. The Service annually produces the Internal Revenue Service Data Book, which clearly delineates that higher income taxpayers will experience an increased rate of examination.

### **YOUR CHANCES OF EXAMINATION ARE OUTLINED BY THE IRS**

The Service outlines examination rate by total positive income, the sum of all positive amounts of income without regard to net losses. The statistics of greatest interest to aircraft operators include the following results for returns filed in 2005:

	<u>Exam Rate</u>
Individual returns income >\$100K	1.3%
Individual business returns (Schedule C) income >\$100K	3.9%
Small corporations ("C Corps") assets \$5M	1.2%
Partnership returns	.4%
S corporation returns	.4%

### **DON'T HIDE FROM EXAMINATIONS – PREPARE FOR THEM**

If you are selected for examination, the areas of concentration are likely to emphasize the "Hobby Loss" rules, and the "Passive Activity" rules. Because an aircraft is "listed property" documentation of use must be contemporaneous. Simply stated, your records must be maintained as you use the aircraft and substantiate use in a business that you are actively involved.

The applicability of Hobby Loss and Passive Limitations will be impacted on not just how the aircraft is owned, but also contractual relationships and tax elections. The impact of personal use on the aircraft will turn on the nature of the use, the manner in which it is provided, and the relationship of the user and the operator.

### **NOT TAKING ALLOWABLE DEPRECIATION DEDUCTIONS WILL REDUCE INCOME TAX BASIS**

Income tax basis of an aircraft used in a trade or business is adjusted for depreciation allowed, or allowable. Therefore, a taxpayer who chooses not to depreciate his business aircraft may find

that he must nonetheless recognize gain on sale if he merely recovers a portion of his original cost. It is therefore imperative that a taxpayer take the deductions he is entitled to while complying with statutory requirements.

#### **ABOVE ALL – DON'T PLAY AUDIT LOTTERY**

Our income tax system is self-reporting and relies on the honesty of the taxpayers. When a taxpayer does not comply, they may find the IRS wrath both swift and severe. Congress is gravely concerned about the “tax gap” created by dishonest taxpayers; and has recently armed the IRS with new penalty provisions to increase compliance.

An aircraft can be an efficient tax savings tool with proper planning and execution. FAA limitations and liability concerns often dictate that the aircraft be owned and operated outside the typical corporate solution. This may inadvertently increase tax complexity, but need not reduce tax effectiveness.

Louis M. Meiners, Jr., CPA, JD

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(888) 325-1942

[loum@advocatetax.com](mailto:loum@advocatetax.com)

*Louis M. Meiners, Jr. is an attorney and CPA who serves as president of Advocate Aircraft Taxation Company. Advocate's practice is limited to serving the needs of owners and operators of aircraft. Services include aircraft operational analysis, sales and use tax management on aircraft acquisitions, income tax planning, federal excise tax planning, and representation before taxing authorities. Meiners can be reached at (888) 325-1942, or [loum@advocatetax.com](mailto:loum@advocatetax.com).*

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