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TAX COURT EMPHASIZES AIRCRAFT RECORDKEEPING

“T and E and out by three,” is a long-standing adage among IRS agents, reflective of the fact that Congress has elevated the recordkeeping requirements for travel and entertainment expenses, and auditors honed-in on these technicalities may be able to make quick adjustments leading to hefty tax bills. The rules do not uniquely target aircraft. Instead, all travel deductions—irrespective of the means of transportation—are subject to enhanced documentation requirements. Failing to meet these technicalities can mean disallowance of expense deductions, even if the IRS auditor genuinely believes that the aircraft was, in fact, used for business. Fortunately, attentive taxpayers armed with knowledge of the requirements should have no difficulty retaining the needed records, and thus avoiding this tax trap.

LYSFORD V. COMMISSIONER

Lysford v. Comm., TC Memo 2012-41, hinged upon application of the recordkeeping rules. The case involved an independent mortgage broker who conducted his day-to-day business out of his home, but frequently also needed to travel for business to a town 200 miles away. He was a pilot and made these trips using a Cessna 182 belonging to a company owned by him and his wife. The only record he kept was a spiral notebook onboard the aircraft, where he would jot down only the date and general destination (i.e., the city) for each flight. Notably absent from his records was any description or identification of customers or business contacts he met with, or any specific statement of the business purpose of any particular trip. The taxpayer was a former airline pilot, already holding an ATP license, who had little or no FAA or insurance need to document his flight-hour experience.

The tax court concluded that the taxpayer had failed to document or substantiate any business use of the aircraft and that, therefore, under applicable statutes, no deductions were allowed. The court wrote that taxpayers must “substantiate by adequate records or by sufficient evidence corroborating the taxpayers’ own statements the amount of the expenses, the time and place of the expenses or use of the property, and the business purpose of the expenses.” Because the taxpayer had not provided information of the specific business purpose of each trip, the court felt bound by law to reject the taxpayer’s claimed deductions, even though it agreed that he “may have conducted some mortgage business” at his destination.

THE TAXPAYER’S BURDEN – KEEP GOOD RECORDS

In a judge’s decision-making as to whether a trip will be considered business or non-business, the playing field is not level. The taxpayer bears the burden to produce records that meet a specification set out in the tax code. A common, but false, line of thinking for business people prior to experiencing an audit goes as follows: “If I take a trip this year, and I file my taxes next year, whatever audit occurs will not happen until two or three years in the future, and at that point it will be very difficult for the IRS to prove that my trip was not business.” This thinking relies on the false assumption of even footing.



The courts dispel the level-field assumption with an oft-repeated phrase from the case law: that “deductions are a matter of legislative grace.” This phrase means, in effect, that taxpayers have no basic right to their tax deductions. They are only available if Congress specifically enacts them and the law can place byzantine limits and restrictions on what taxpayer must do to receive them. The travel substantiation rules are just such a restriction. Fortunately, the information they require taxpayers to retain is narrow and specific. Taxpayers armed with this knowledge, and who keep to good habits, should have no difficulty overcoming this hurdle.

THE FOUR ELEMENTS OF SUBSTANTIATION

The law requires that travel expensesⁱ for each passenger on each trip to be substantiated with records, made during or soon after the trip, to show the four following elements:

1. The amount of the expense,
2. The dates of departure and return and number of days away spent on business,
3. The destination or locality of travel, and
4. The business reason for the travel or the nature of the business benefit derived or expected.

At first blush, the “amount of expense” requirement of item 1 could pose a difficulty for aircraft because many fixed expenses will not be directly associated with any particular trip. Fortunately, the IRS regulations deal with this by establishing a special “aggregation” rule. All expenses of an aircraft should be tracked and aggregated over the course of the tax year. Records (receipts and invoices) must show the date and amount of each expense. Based on these aggregated expenses, the taxpayer may prorate over the total use of the property during the year to establish expenses associated with any particular trip.

When a taxpayer is forewarned of the elements to prove for each trip, the substantiation rules should not pose a major obstacle. Recordkeeping with an eye to these four simple elements should allow avoid this tax trap.

CONCLUSION

Good recordkeeping is a matter of good habits. An aircraft operator seeking to deduct business travel expenses must always be mindful of the four elements that must be established in order for the IRS to allow travel deductions. Furthermore, the persuasiveness of recordkeeping can be enhanced through the use of multiple sources. The flight log, email, and calendar are often three critical sources of documentation. If the flight log shows the trip, and the calendar shows the meeting/s that occurred on the trip, and the taxpayer’s personal email history shows the messages exchanged pertaining to the meeting/s, these records can work together to weave a convincing picture of business usage that the IRS is unable to dismiss. This memorandum is not intended, and should not be read as, a comprehensive treatment of its subject matter. Always consult a qualified professional.

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Advocate Consulting Legal Group, PLLC is a law firm whose practice is limited to serving the needs of aircraft owners and operators relating to issues of income tax, sales tax, federal aviation regulations, and other related organizational and operational issues.

This article provides an introduction to a complex, and often ambiguous, area of law. Knowledgeable people may disagree as to outcomes in particular cases. Always consult with your advisor.

ⁱ Slightly different rules govern general travel expenses than expenses for items of “listed property” (which includes any property “used as a means of transportation”). However, the overlap in the rules is so significant that they are comingled in this article.