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Hobby Loss Rule - does it affect your aircraft deductions?

Internal Revenue Code Section 183 (Activities Not Engaged in for Profit) limits deductions that can be claimed when an activity is not engaged in for profit. This is sometimes referred to as the “hobby loss rule.” For example, the tax court docket has many cases involving horse breeding activities disguised as profitable businesses by taxpayers. As aircraft have come under increasing scrutiny by the Internal Revenue Service (IRS), tax examiners have attempted to apply this code section to business aircraft owners.

Is your aircraft really an activity engaged in for profit? This is the question an IRS auditor likes to ask. A properly structured and documented business aircraft should seldom have to deal with the hobby loss rule.

Unless you are involved in an aircraft rental and leasing business, your aircraft should be viewed as an asset being utilized in your operating business, and not a stand-alone aircraft business, as it is often difficult to justify the aircraft as profitable on a stand-alone basis.

For example, if you are a construction contractor and you use your aircraft to visit job sites and vendors, attend trade shows and conventions, your business aircraft is, in fact, a business tool for your construction business, similar to a bulldozer and other construction equipment. This is obvious when the aircraft is owned within the contractor business entity.

For various legal, financial and tax reasons, a business aircraft is often owned by a separate legal entity, like a limited liability company (LLC). This is when the IRS likes to invoke the hobby loss rule in an attempt to disallow the aircraft deductions. For this reason, determining who should be the member of the aircraft LLC is critical.

Case laws support the concept of grouping, where the contracting or operating business and the aircraft “business” are grouped together when the profitability and hobby loss rule tests are applied. If the contracting business is profitable, by virtue of a grouping election, your aircraft business is also profitable. The requirement to group is met by demonstrating that the two businesses are inter-related, which is typically the case when the aircraft is used for various contracting business trips. A detailed and well documented flight log and a business plan or financial projection are useful in proving the appropriateness of grouping the aircraft with an operating business.

To find out more, please visit our website, www.aviationtaxconsultants.com or call us at **1-800-342-9589**.

Aviation Tax Consultants, LLC assists aircraft purchasers in acquiring aircraft in a tax efficient manner. Our services include the elimination or reduction of sales tax at the time of purchase, maximizing income tax savings, controlling the cost of personal use of the aircraft, complying with passive activity loss and related party leasing rules and Federal Aviation Regulations. Cooperation with client’s current tax and legal advisors is welcome and encouraged.

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