

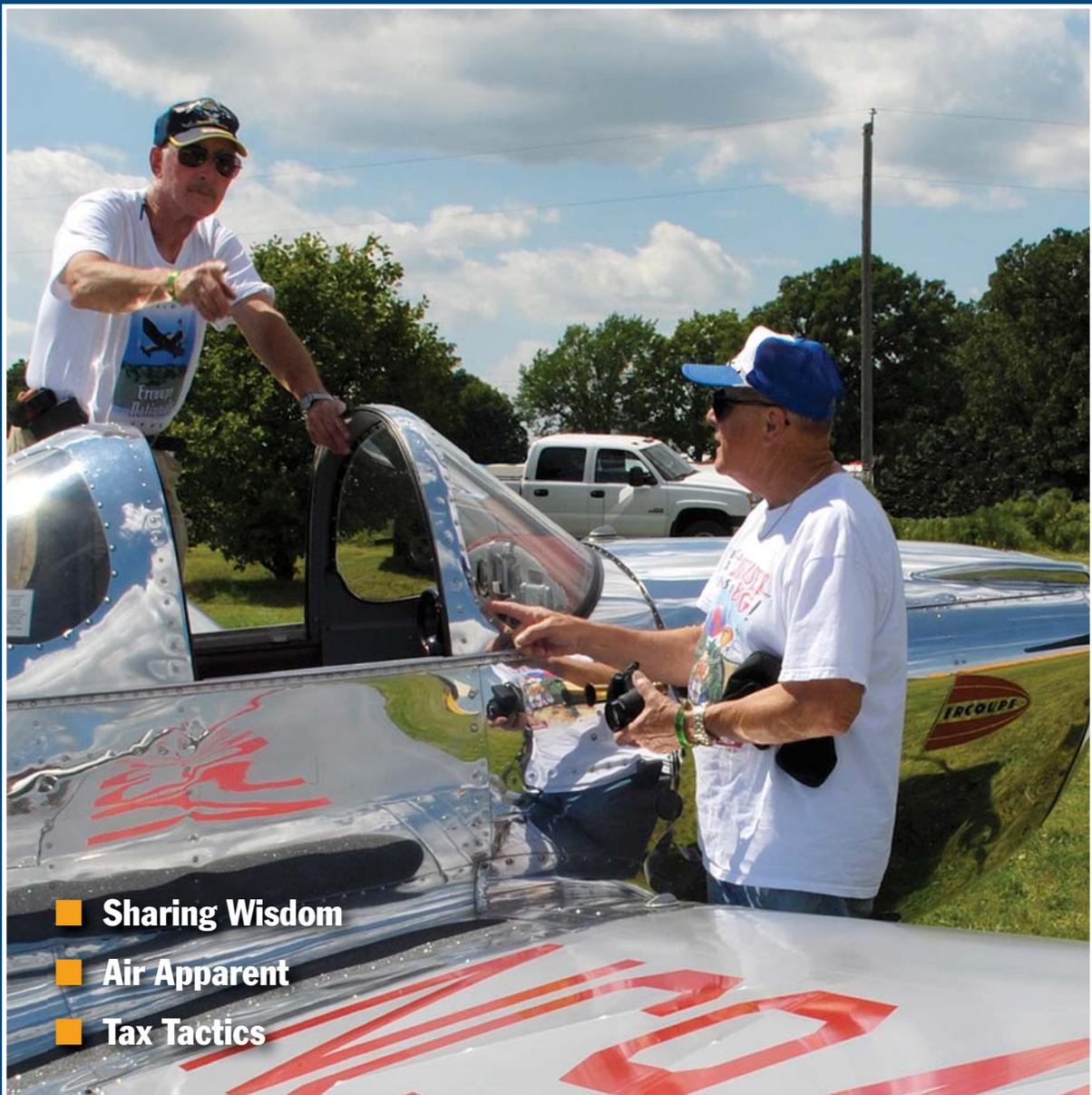
# THE PROFESSIONAL FLIGHT INSTRUCTOR

# MENTOR

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- **Sharing Wisdom**
- **Air Apparent**
- **Tax Tactics**

# Tax Tactics

## Money-saving considerations for flight instructors

BY JEFFREY B. GILBERT

**T**ax season is upon us again, and as a flight instructor, it's worth considering some special tax areas when preparing your annual return. It's possible that you may have some deductions available to you that you had not previously thought about.

I would be remiss if I didn't include a liability disclaimer that the tax advice contained herein is not intended or written to be used—and cannot be used—by a taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. It is important that, as you complete your tax filing, you consult your tax advisor regarding how this article may relate to your individual circumstances.

### Employee or Contractor?

One of the first things to determine as a certificated flight instructor (CFI) is whether you should be an employee or independent contractor. The flight school you work for may not give you a choice; however, you have a choice as to which flight school you work for, and this will be part of the decision process. An employee will cost a flight school more than an independent contractor. Your individual circumstances will determine which position will yield the better tax benefits for you.

A common-law employee is controlled and directed by an employer. He is told when to work, is told how to do his job, and generally is given the tools to perform his job. An employee receives a W-2 at the end of the year and has taxes withheld

from his pay.

An independent contractor (IC) is a self-employed individual who is either a sole proprietor or a single-member limited-liability company (LLC). This person receives a Form 1099 instead of a W-2 and has no taxes taken out of his compensation. An LLC is a separate legal entity that is not a separate tax entity; an LLC generally protects a member from personal liability; however, that discussion is beyond the scope of this article.

An employee pays half of the Social Security and Medicare taxes of what an IC would pay. An employee pays the tax on his gross wages, while an IC pays these taxes on his net earnings after expenses. An employee may receive from his employer fringe benefits, such as major medical coverage and workers compensation, paid vacations, holidays, and sick leave, while an IC generally receives none of these. An employee, when laid off, can receive unemployment compensation; an IC cannot. An employer is generally liable for the actions of their employees; an IC can be held jointly liable with the flight school.

An independent contractor files a Schedule C Profit or Loss From Business form with her income tax return. All ordinary and necessary business

**The IRS has strict substantiation requirements. You generally need documentary evidence such as receipts, canceled checks, or bills to support your expenses.**

expenses may be deducted from gross income to arrive at net profit from business activity. In tax language, these expenses are *above the line expenses*. These business expenses may be deducted from gross income, and the taxpayer may still use the *standard deduction* or *itemized deductions* to arrive at *taxable income*. Income tax is calculated on taxable income.

Employees are at an income tax disadvantage when it comes to business expenses, as they may only deduct business expenses as *miscellaneous itemized deductions*. Therefore, if you use the standard deduction and don't itemize, you get no tax benefit for business expenses. In addition, if you itemize, your deduction is further limited to the amount in excess of 2 percent of your *adjusted gross income*. See Table 1 for an example of the difference between the taxes paid by an employee versus an IC.

If you work as an employee for a flight school or fixed base operator, but also "moonlight" with outside customers, you should consider the fact that you are also acting as an IC in those cases. This is also true of those of you who are designated pilot examiners and are receiving compensation for your flight-check duties. These outside incomes should be reported as additional income

**Table 1: Comparable tax payments for a flight instructor, assuming the instructor is working in New York, earns \$50,000, and has business expenses of \$10,000 (2008 tax rates).**

	<b>Employee</b>	<b>Independent Contractor</b>
Gross income	\$50,000	\$50,000
Business expenses	-	10,000
Other adjustments	-	<u>2,826</u>
Adjusted gross income	50,000	37,174
Standard or itemized deductions	11,413	5,450
Exemption	<u>3,500</u>	<u>3,500</u>
Taxable income	<u>\$37,120</u>	<u>\$28,224</u>
Income tax	\$7,526	\$5,469
Social Security & Medicare tax	<u>3,825</u>	<u>5,652</u>
<b>Total tax</b>	<b><u>\$11,351</u></b>	<b><u>\$11,121</u></b>

that was not taxed at the time of service and is eligible for taking *above the line expenses* upon form Schedule C. There have been many instructors who have not realized until the end of the year that a significant portion of their income when acting as an IC is taxable and have ended up owing taxes on the year. Coming up with a big check to pay at that point can be tough, so plan ahead.

### Business Expenses

Section 162 of the Internal Revenue Code (IRC) discusses the deductibility of expenses. Any taxpayer may deduct all *ordinary and necessary* expenses incurred in carrying on a trade or business. The expenses relating to flight instructing and commercial flying include uniforms, supplies, equipment, training, currency, and travel, to name a few. Books and materials used in instruction certainly would be included in this listing of deductible expenses. (See Table 2 for an expanded list.)

All that said, the IRS has strict substantiation requirements. You generally need documentary evidence such as receipts, canceled checks, or bills to support your expenses. Documentary evidence is not needed if your travel expense (excluding lodging) is less than \$75; however, you will need

to keep the proof in an account book or diary or similar record.

Some of the important areas of ordinary and necessary business expenses are as follows:

*Training.* The IRC regulations require that qualifying education expenses be (a) connected with a trade or business, and (b) tested against four criteria—two qualifying and two disqualifying—to determine whether the expenses can be deductible. Education expenses are deductible if the education does either of the following: (1) It maintains or improves skills required by the individual in his employment or other trade or business; (2) it meets the express requirements of the individual's employer or the requirements of applicable law or regulations, imposed as a condition of an established employment relationship, status, or rate of compensation. The deduction will be disallowed if either of two disqualifying criteria is present: (1) The education is required to meet the minimum education requirement for qualification in the taxpayer's employment or other trade or business; (2) the education is part of a program of study that will lead to qualifying the taxpayer for a new trade or business.

What does this all mean? The

**Table 2: Common business expenses for flight instructors.**

- Cockpit supplies
- Charts
- Headset
- Flashlight and batteries
- Sunglasses
- Flight bag
- Logbook and manuals
- Personal organizer
- Cell phone and pager
- Luggage
- Portable toiletries
- Internet access
- Computer
- Special clothing
- Professional dues
- Professional publications
- Insurance
- Currency expenses
- Medical exam
- Training
- Tips
- Business cards
- Postage
- Auto expenses
- Other miscellaneous supplies
- Postage
- Job hunting
- Business gifts
- Parking
- Laundry and dry cleaning
- Portable GPS

training costs of obtaining your commercial and flight instructor certificates and your instrument rating are not deductible, but once you are a working CFI, the cost of obtaining further ratings (instrument instructor, multiengine instructor, and so on) does not change your occupation and is deductible.

Here's a tax-planning tip regarding continuing education and recurrent training (currency requirements). Combining business and pleasure can be a tax-deductible business expense if the primary purpose of the activity is business. A trip to EAA AirVenture Oshkosh or the Sun 'n Fun Fly-In at Lakeland, Florida, is a deductible vacation when you go to these shows for the seminars

and displays that improve your job skills and knowledge. A night cross-country trip to Martha's Vineyard for instrument flight rules currency and night practice—including a nice dinner on the island—becomes a tax-deductible event, as well. Bringing a passenger or two does not negate the purpose of the flight.

*Per Diem Business Travel.* Whether you're instructing or flying using your commercial certificate under Part 91 or 135, out-of-town overnight travel has some special rules that you can take advantage of. In lieu of being reimbursed for actual travel expenses (meals, lodging, and incidentals), you may be reimbursed a *per-diem allowance*. No accounting is necessary, and the amount you receive is non-taxable even if you don't spend the whole amount of the per-diem allowance. The IRS analyzes the current costs of overnight lodging in various cities and annually issues per-diem rates based upon whether your travel brings you to a high-rate or low-rate locality. The per-diem rate is broken down between two categories: (1) lodging and (2) meals and incidental expenses (M&IE). The latest lodging per-diem rates were \$256 and \$158 per night, and the M&IE rates (exclusive of lodging) were \$58 and \$45 per day.

*Airplane Ownership.* If you are self-employed or considering becoming self-employed, you may want to consider purchasing an airplane to do your flight instructing. I could write a whole article on this subject alone, but suffice it to say the tax laws allow a taxpayer to deduct (depreciate over five years) the whole cost of the airplane. For 2008—and expected for 2009—80 percent of a new plane cost can be deducted in the year of acquisition, subject to certain limitations.

This should give you some insight as to some of the particulars of our profession and industry. As you work to

complete your taxes this season, take the time to look at the expenses you have that are directly related to your profession and how you were paid to conduct your flight instruction. You may have some deductions that you had not previously considered. Take the time to go over these with your ac-

countant before you prepare your tax return; you may find yourself with a return that's worth the investment.

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