STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

David M. McInnis Petitioner, vs. South Carolina Department of Revenue, Respondent.	)	Docket No. 13-ALJ-17-0443-CC **ORDER GRANTING MOTION FOR RECONSIDERATION & FINAL ORDER AND DECISION**

APPEARANCES: For the Petitioners: Burnet R. Maybank, III, Esquire and James P. Rourke, Esquire

For the Respondent: Carol I. McMahan, Esquire

STATEMENT OF THE CASE

This matter is before the South Carolina Administrative Law Court (ALC or court) for a contested case hearing pursuant to Section 12-60-2540(A) of the South Carolina Code. S.C. Code Ann. § 12-60-2540(A) (2011). The South Carolina Department of Revenue (Department) conducted an audit of 2008-2010 tax records filed by David M. McInnis (Petitioner). The Department reclassified the income reported by the Petitioner as to his aviation activities taking the position that the activities were a hobby and could not be reported as a business. The Petitioner filed a timely protest contesting the Department's adjustment. After review, the Department disagreed with the Petitioner and issued a Final Agency Determination on August 23, 2013. On September 11, 2013 the Petitioner filed a request with the court for a contested case hearing. After notice to the parties, a hearing was held before this court on May 13, 2014. The sole issue before the court is whether the Petitioner's aviation activity as to the Cirrus aircraft was engaged in for profit under Section 183 of the Internal Revenue Code. 26 U.S.C. § 183 (1988).

The Court issued a Final Order and Decision in this case on August 28, 2015. On September 8, 2015, a Department attorney who was not present at the contested case hearing, filed a "Motion for Reconsideration Under Rule 29(D) to Reconsider,

Alter, and/or Amend Under Rule 59 (e), SCRCP" (Motion for Reconsideration). The Petitioner responded and the Department filed its reply.

State offices were closed the week of October 5, 2015 due to unforeseen circumstances. In order to thoroughly review and consider those matters raised by the Department's Motion for Reconsideration,[1] the court vacated its Final Order and Decision on October 16, 2015. The Motion for Reconsideration is deemed granted as this Final Order and Decision takes into account those matters raised by the Department in its Motion for Reconsideration. To the extent that any arguments in the Department's motion have been raised but not specifically addressed herein, the court rejects those arguments.

FINDINGS OF FACT

Based upon a careful consideration of the evidence presented and the credibility of the witnesses, the court makes the following Findings of Fact. In making such findings, the court has taken into consideration the burden of the parties to establish their respective cases by a preponderance of the evidence:

1. This court has personal and subject matter jurisdiction. Proper notice of the date, time, place, and nature of the hearing was timely given to all parties.

2. The following numbered statements have been stipulated by the parties:

(a) The tax periods at issue are tax years ending December 31, 2008, 2009, and 2010 (tax periods).

(b) The Petitioner, a licensed orthodontist, resides in and operates an orthodontics practice in Pickens County, Easley, South Carolina, currently and for all periods at issue in this determination.

(c) The orthodontics practice is named, Dean and McInnis P.A., and is an S Corporation.

(d) The Petitioner timely filed his South Carolina individual income tax returns for tax years 2008, 2009, and 2010, using the married filing separate filing status.

(e) The Petitioner's returns for the years 2008 through 2010 were examined by the Department's auditors and various adjustments were made. All matters were resolved

[1] Rule 29(D)(2) of the ALC Rules places time constraints on the court in acting on motions for reconsideration. Inaction within the prescribed period constitutes a denial of the relief sought in the motion.

with the exception of issues relative to whether the Petitioner's aviation activities in which he is engaged are for profit, or simply a hobby.

(f) The Schedule C's attached to the Petitioner's income tax returns for 2008 through 2010 reflected as part of the Petitioner's gross income and expenses reported, that associated with the Petitioner's aviation activities, Carolina Creative Leasing, LLC (CCL). CCL is a single member limited liability company (LLC) and the Petitioner has elected to report income and deductions each tax year on a Form Schedule C filed with his individual income tax returns. Thus, for tax reporting and liability purposes, CCL is the Petitioner.

(g) The Petitioner obtained a pilot's license in 2007 (Private Pilot; Airplane Single Engine Land Instrument Airplane). His medical rating for the license is Third Class.

(h) In 2008, the Petitioner purchased an SR22-G3 GTS Turbo Cirrus aircraft. The aircraft was financed through Bank of America.

(i) The Department issued a Proposed Notice of Adjustment to which the Petitioner filed a timely protest.

3. The parties also stipulated the amounts of depreciation and deductions at issue:

Deduction	2008	2009	2010	Totals
Federal Tax Depreciation	-$384,516.00	-$60,667.00	-$43,326.00	-$488,509.00
SC Additions to income-Depreciation Adjustment	$235,924.00	$0.00	$0.00	$235,924.00
SC Subtractions to income-Depreciation Adjustment	$0.00	-$60,667.00	-$43,326.00	-$103,993.00
Insurance	-$10,300.00	-$9,071.00	-$6,582.00	-$25,953.00
Interest	-$7,860.00	-$32,032.00	-$34,086.00	-$73,978.00
Lease(Rent)	$0.00	$0.00	-$1,600.00	-$1,600.00
Taxes/Licenses	$0.00	-$2,826.00	-$2,353.00	-$5,179.00
Other	-$2,524.00	-$15,340.00	-$14,399.00	-$32,263.00
Total Deductions Per Federal Form 1040 Schedule C return plus/minus any SC adjustments for depreciation	($169,276.00)	($180,603.00)	($145,672.00)	($495,551.00)

4. During the periods at issue, the Petitioner's orthodontics practice had approximately ten (10) employees and generated roughly $1,600,000.00 in gross revenue per year. In addition, Petitioner owned four (4) rental properties in the Charleston area. The Petitioner's

wife is an owner of a large Mercedes Benz automobile dealership, Carlton Motorcars, Inc., which employed about forty-five (45) people and generated more than $30,000,000.00 in annual gross revenue. The Petitioner's wife worked at the dealership in excess of forty (40) hours per week.

5. The Petitioner first identified the possibility of establishing an airplane leasing business when Cirrus began marketing non-commercial flight in Greenville, South Carolina through its Flying 2.0 marketing campaign. After conducting extensive research and consulting with various experts, the Petitioner identified potential customers of a leasing business. These customers included the Petitioner's orthodontics practice, Dean and McInnis P.A., and his wife's Mercedes dealership, Carlton Motorcars, Inc., in addition to third party lessees. At this same time in 2008 and 2009, the Petitioner and his wife considered purchasing another Mercedes Benz dealership in Florence, South Carolina, which would require frequent visits for oversight purposes. The Petitioner and his wife went so far as to place a down payment on the dealership. The Petitioner believed the totality of his and his wife's business ventures only could be effectively managed using the efficient travel options that non-commercial air travel could provide.

6. The Petitioner purchased the Cirrus aircraft in September of 2008 and obtained insurance for it in October of 2008.

7. The plane was titled in the name of the Petitioner's single member LLC, CCL.

8. CCL received substantial rental income from its four (4) rental properties during the audit period.

9. The Petitioner managed both his medical practice as well as CCL during periods at issue.

10. The same accounting firm prepared the tax returns for the Petitioner's medical practice, individual income tax return, and CCL.

11. The Petitioner had a regular pilot's license, as well as an instrument flight license.

12. The Petitioner owned three (3) ultralight airplanes which he used for pleasure flying during the audit period. He purchased and owned these planes in his individual capacity and did not depreciate or deduct any costs or expenses relating to them. Additionally, the Petitioner maintained a leasing arrangement with ADM Air during the periods at issue to accommodate him and his family when taking non-commercial pleasure or recreational flights.

13. The Petitioner's Cirrus aircraft is a more advanced and expensive plane to operate than his other aircraft.

14. During the during the audit period, the Petitioner leased other planes for pleasure travel for him and his family during the audit period.

15. The Petitioner is one (1) of approximately thirty (30) orthodontists in a thirty (30) mile range from his office.

16. The majority of the Petitioner's orthodontics practice patients came from referrals from dentists. Only a small percentage of his patients are walk-in appointments. The Petitioner does not advertise his practice as it is frowned upon by his profession.

17. The Petitioner's business plan was to lease the plane under Federal Aviation Administration (FAA) regulations, specifically 14 C.F.R. Part 91 (FAA Part 91). The FAA imposes numerous restrictions on the leasing of planes.

18. Aircraft can also be chartered under 14 C.F.R. Part 135 (FAA Part 135). The FAA's chartering regulations have fewer restrictions, but chartering is much more expensive. For example, under FAA Part 91, the owner is required to have an annual overhaul of the plane. However, under FAA Part 135, an overhaul is required every 100 hours. Each overhaul costs between $7,000 and $8,000.

19. The Petitioner conducted due diligence before and after purchasing the plane. This included consultations with aircraft owners who chartered and leased their aircraft; two attorneys; and an aviation consulting firm. The Petitioner also worked with an accounting firm that represented other aviation clients

20. CCL's business plan was to charter the plane to both related and non-related customers.

21. The Petitioner leased the plane to his orthodontics practice, which was billed for each flight and charged $600 per hour for use of the plane.

22. The Petitioner used the plane in his orthodontics practice to: (a) attend required continuing education seminars; (b) to visit dental schools and dental specialists in other states; and (c) to fly referral sources (dentists) to visit other dental schools and specialists.

23. The Petitioner testified that flying his referral sources to visit other schools and specialists was very successful as it resulted in a significant increase in patient referrals.

24. CCL also leased the plane to the Petitioner's wife's Mercedes Benz dealership. The plane was used to visit other dealerships, to visit Mercedes Benz management, and once, to fly a technician to Florida to repair a customer's automobile.

25. The Petitioner spent a significant amount of time training in the Cirrus during the end of 2008 and beginning of 2009. He completed this training in order to obtain his instrument rating certificate, which allowed the Petitioner to fly in variable weather conditions and comply with FAA regulations. Additionally, throughout the periods at issue, the Petitioner's logs reveal that the aircraft logged hours for maintenance. Both training time and maintenance were related to the Petitioner's CCL business.

26. The Petitioner's tax returns showed that his combined businesses (orthodontics practice, and CCL) showed a net profit in all three (3) audit years: $527,623 in 2008; $204,035 in 2009; and $360,844 in 2010. This net profit was calculated after fully deducting all depreciation, interest and operating costs related to the Cirrus in the following manner:

	2008	2009	2010
J. Thomas Dean, DDS & David M. McInnis, DDS:			
Taxable Wage Income (Form W-2)	$259,615.00	$250,000.00	$250,000.00
S Corporation - Ordinary business income	$354,886.00	$29,465.00	$96,065.00
Carolina Creative Leasing, LLC:			
Federal Net Rental Income from Building/Equipment	$73,611.00	$105,582.00	$121,597.00
SC Depreciation Adjustment	$8,787.00	-$14,585.00	-$8,646.00
SC Net Rental Income from Building/Equipment	$82,398.00	$90,997.00	$112,951.00
Subtotal	$696,899.00	$370,462.00	$459,016.00
Carolina Creative Leasing, LLC:			
Aviation Services SC Net Taxable Income (Loss)	-$169,276.00	-$166,427.00	-$98,172.00
SC Net Taxable Income from trade/business activity	$527,623.00	$204,035.00	$360,844.00

27. While unprofitable, the Petitioner carried out his aviation activities in a businesslike manner.

28. The court finds by a preponderance of the evidence that the Petitioner maintained complete and accurate business books and records.

29. The Petitioner spent twenty (20) to thirty (30) hours per month on his aviation business.

30. The Cirrus depreciated in value during the audit period.

31. The Petitioner's various businesses shared a close organizational relationship. He was the sole manager of both and was the single member of CCL, which owned the rental properties in Easley, Charleston, and the Isle of Palms, South Carolina, and the Cirrus. The Petitioner was also the sole shareholder of the S Corporation under which the orthodontic practice was operated.

32. The Petitioner's orthodontic practice significantly benefitted from the Cirrus. He was able to advance his professional skills and experienced a very positive increase in patient referrals.

33. The Petitioner used the Cirrus to market his orthodontics practice by flying nearby practicing dentists, his referral sources, to schools and to see specialists. He also used it to travel to areas to examine new equipment that would benefit his practice.

34. The Petitioner managed both CCL and the orthodontic practice.

35. The Petitioner used the same accountant for his orthodontics practice and CCL.

36. The Petitioner, and his orthodontics practice and CCL were all calendar year taxpayers.

37. Hobby loss audits under the federal income tax code typically examine three (3) out of five (5) tax years.

38. The Department's audit consisted of the three (3) startup years for the Petitioner's aviation business (2008 – 2010).

39. The Petitioner's aviation activities during the first year of the audit, 2008, consisted of only the last three (3) months of the calendar year.

40. CCL attempted to market leases of its aircraft to businesses in the Greenville area during the audit period, but had little success. The Petitioner attributed the lack of business to the deteriorating economic conditions during the three (3) years related to the audit. According to his testimony, businesses were financially unable or unwilling to enter into long-term leases due to the volatile economy and the availability of short-term leases from other carriers. Leasing of aircraft is a discretionary expense that businesses chose to forego during the period of depressed economic conditions.

41. During the audit period, the aviation industry suffered from the poor national economic conditions. In the Greenville area, the two (2) major FAA Part 135 aviation charter businesses ceased operating.

42. The U.S. Congress ratified the Economic Stimulus Act of 2008 (Pub. L. 110 – 185, 122 Stat. 613, enacted February 13, 2008). The Act was designed to increase spending by large and small businesses on capital goods including airplanes, as part of an effort to stimulate the economy. The Act accomplished this in part by authorizing bonus or accelerated depreciation.

CONCLUSIONS OF LAW

Based upon the stipulation and above findings, the court concludes the following as a matter of law.

1. The South Carolina Administrative Law Court has jurisdiction over this matter pursuant to Sections 12-60-2540(A);[2] 1-23-600;[3] and 1-23-310[4] *et seq.* of the South Carolina Code.

2. In presiding over this contested case, the court serves as the finder of fact and makes a *de novo* determination regarding the matters at issue. *See Brown v. S.C. Dep't of Health & Envtl. Control*, 348 S.C. 507, 512, 560 S.E.2d 410, 413 (2002).

3. The weight and credibility assigned to evidence presented at the hearing of a matter is within the province of the trier of fact. *See S.C. Cable Television Ass'n v. S. Bell Tel. & Tel. Co.*, 308 S.C. 216, 222, 417 S.E.2d 586, 589 (1992).

4. The court who observes the witnesses, is in the best position to judge those witnesses' demeanor and veracity to over evaluate the credibility of their testimony. *Rowland v. S.C. Dep't of Revenue*, 2008 WL 3863554 (S.C. ALC July 25, 2008) (*citing Woodall v. Woodall*, 322 S.C. 7, 10, 471 S.E.2d 154, 157 (1996); *Wallace v. Milliken & Co.*, 300 S.C. 553, 556, 389 S.E.2d 448, 450 (Ct. App. 1990)).

5. The standard of proof in these administrative proceedings is a preponderance of the evidence. *See Anonymous v. State Bd. Of Med. Exam'rs*, 329 S.C. 371, 496 S.E.2d 17 (1988).

6. In a contested case hearing, the burden of proof is upon the party asserting the affirmative of an issue. *Smith v. S.C. Dept of Revenue*, No. 09-ALJ-17-0531-CC, 2010 WL 5781641 (S.C. ALC December 23, 2010) (*citing Leventis v. Dep't of Health and Envtl. Control*,

---

[2] (1995).
[3] (Supp. 2010)
[4] (2005 & Supp. 2010).

340 S.C. 118, 132-33, 530 S.E.2d 643, 651 (Ct. App. 2000)). In this instance, the Petitioner bears that burden.

7. South Carolina has adopted the federal statutory frame work for determining whether an activity is engaged in for profit with certain caveats.

8. Section 12-6-560 of the South Carolina Code provides that "[a] resident individual's South Carolina gross income, adjusted gross income, and taxable income is computed as determined under the Internal Revenue Code (IRC) with the modifications provided in [§§ 12-6-1110 – 1220]." S.C. Code Ann. § 12-6-560 (1995). *See also*, S.C. Code Ann. § 12-6-50 (2013) (Internal Revenue Code sections specifically not adopted by the State).

9. Section 16 of the IRC allows a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." 26 U.S.C.A. § 162. Similarly, Section 212 of the IRC allows individuals a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year - - (1) for the production or collection of income ..." 26 U.S.C.A. § 212.

10. In order for the expenses to be deductible under Sections 162 or 212 of the IRC, the taxpayer must engage in or carry on an activity to which the expenses relate with an actual and honest objective of making a profit. In the case of an activity engaged in by an individual or an S corporation, "if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed" except as provided under Section 183 of the IRC.

11. Under Section § 1.183-2(a) of the Treasury Regulations, "[t]he determination whether an activity is engaged in for profit is to be made by reference to objective standards, taking into account all of the facts and circumstances of each case." The regulations identify nine relevant factors in determining whether an activity is engaged in an activity for profit. While no one (1) factor is determinative and collectively, they are not exclusive, they are helpful in providing a framework from which to begin the analysis. 26 C.F.R. § 1.183-2(a), Treas. Reg. § 1.183-2(a).

12. These nine (9) factors include the following: (a) the manner in which the taxpayer carries on the activity; (b) the expertise of the taxpayer or his advisors; (c) the time and effort and effort expended by the taxpayer in carrying on the activity; (d) the expectation that assets used in activity may appreciate in value; (e) the success of the taxpayer in carrying on other similar or dissimilar activities; (f) the taxpayer's history of income or losses with respect to the activity; (g) profits actually earned and possibility of ultimate profit; (h) the financial status of the taxpayer;

and (i) the elements of personal pleasure or recreation. *Id.* An application of these factors to the facts of this case is discussed below.

The manner in which the taxpayer carries on the activity.

13. According to the regulations, a profit motive may be indicated where "the taxpayer carries on the activity in a businesslike manner and maintains complete and accurate books and records." 26 C.F.R. § 1.183-2(b)(1), Treas. Reg. § 1.183-2(b)(1). Prior to the purchase of the plane, the Petitioner retained an aviation tax consultant to assist in setting up the business to insure it would comply with FAA regulations, tax laws and regulations, and to insure prudent business practices were utilized including the maintenance of proper documentation. Additionally, prior to purchasing the Cirrus, the Petitioner met with his accountant to analyze aircraft expenses to determine the best business model to use.

14. The Petitioner's accountant established a system of books and records. The Petitioner kept complete records regarding the use of the airplane for the periods at issue. The Petitioner maintained accurate bookkeeping and logs including maintenance and travel logs.

15. The Petitioner's S-corporation, CCL, entered into lease agreements with clients and sent invoices to those clients to solicit payment for services provided. Separate accounts were maintained. The Department's auditor who conducted the Petitioner's audit, conceded in her testimony that the Petitioner maintained complete and accurate books and records.

16. The court concludes that the Petitioner established by a preponderance of the evidence that he possesses more than the mere "trappings" of a for profit business. *See Yates v. Comm'r*, T.C. Memo 1996-499.[5]

17. In its Motion for Reconsideration, the Department disagrees with the court's view of the evidence and its finding by a preponderance that the Petitioner met his burden of proof as to this factor. The Department argues that the manner in which the Petitioner conducted his aviation activity undermines any legitimate profit motive yet provides no evidence that was not already presented and considered by the court in making its ruling.

18. The Department argues that the Petitioner's for profit motive is suspect since during the three (3) years, the insurance purchased for the Cirrus was only for pleasure and business related purposes "where no charge is made for such use." The Department continues by stating

[5] 1996 WL 637877.

that there do not "appear to be endorsements [to the insurance] altering the applicability of this 'pleasure and business.'"[6]

19. The Department failed to successfully impeach any evidence presented by the Petitioner at the hearing, including the Petitioner's testimony. While it was the Petitioner's burden to establish a for profit motive, the Department did not rebut the case presented by the Petitioner.

20. In its Motion for Reconsideration the Department overlooks or fails to acknowledge the Petitioner's testimony that after consulting with experts, he elected to proceed under FAA Part 91 and purchased insurance mandated by Part 91. The insurance purchased was for bareboat charters. A bareboat charter is one in which the person leasing the plane provides his own insurance, fuel, and pilot. Whether the Petitioner was correct in his interpretation of the type of insurance required by Part 91 is irrelevant at this juncture as the Department presented no evidence to the contrary at the hearing. The court was left with the undisputed testimony of the Petitioner. What is relevant is the Petitioner's unrefuted testimony that what he purchased was what was required by Part 91.[7]

21. The Department points out in its Motion for Reconsideration (but not at the hearing) that the policy purchased by the Petitioner which prohibits charging for the use of the plane, is inconsistent with a legitimate profit motive. The Department also advances the position that a "bare boat" charter "defies logic" that a leasing entity would purchase its own insurance. First, the fact the Petitioner sought out leases, leased the aircraft, and then charged and billed for it is clear and convincing evidence of a legitimate "for profit" intent regardless of whether the Petitioner was in compliance with or contravention of FAA Part 91 or the insurance policy.[8] Second, the Department ignores the Petitioner's undisputed testimony as to "bare boat" charters. At the hearing, the Petitioner testified in part that "... it's not a one-stop shop ... you're leasing the aircraft, the use of the aircraft, pilot services and things like that are separate entities. And you - - basically bring those yourself." The Petitioner testified that it is called a "dry lease."

---

[6] As an aside, the court notes the use of the Department's choice of words, "there do not appear to be any endorsements."

[7] The Department presented no testimony to contradict the Petitioner's assertions as to what was required by Part 91. Thus, the only evidence with which this court was left was the Petitioner's unrefuted testimony. The Department merely asked the Petitioner if he had brought a copy of the regulations to the hearing.

[8] The only evidence presented at the hearing was that the Petitioner was in compliance with FAA Part 91.

22. The Department cites *Yates, supra*, for the proposition that a profit motive may fail to exist when a taxpayer fails to abandon unprofitable methods and adopt new techniques. The court in *Yates*, utilized the specific word, "may."[9]

23. The Department elected to audit the Petitioner for only three (3) years[10] during which time the Petitioner's aviation business was only in operation for twenty-seven (27) of the months of the audit period. Aside from the facts that these were the Petitioner's startup years, and FAA Part 91 prohibits certain types of advertising (which was unrefuted at the hearing and the Department's attempt to cross-examine the Petitioner on this point was ineffective as was the testimony the Department elicited from its sole witness, the auditor, the court finds that the Petitioner had not even been in business for a sufficient amount of time[11] to identify what may have been profitable or unprofitable methods and to develop new techniques.

24. During the audit period, other fixed based operators about which the Petitioner was aware went into bankruptcy in South Carolina including ADM Air and SATSair.

25. In its Motion for Reconsideration, the Department notes that the Petitioner's method of billing is suspect since invoices were sent eighteen (18) months after services were performed. This is an issue of fact for the court; the fact that Department disagrees with the court's view of the weight of the evidence, is not grounds for reversal. Here, the Department provided absolutely no evidence that this was an improper billing practice, and the court found the Department's cross-examination of the Petitioner to be unproductive.[12] Finally, the Department provided no evidence that the invoices were not paid or that the Petitioner failed to pursue payment.

26. The Department now notes that there were only four (4) bills for leasing of the aircraft in three (3) years to the Petitioner's orthodontic practice and his wife's car dealership. The

---

[9] The court notes that in *Yates*, the fact the Petitioners were employed as full-time nurses did not necessarily preclude a finding that the Petitioners bred horses with a profit motive.

[10] The Department may select any audit period it so chooses. Here, it elected to audit within a very limited period during which (a) the Petitioner's business was only operational for twenty-seven months (27) months of the audit period; (b) the audit coincided with the "startup" of the business; and (3) the country was suffering from a recession. The only issue before the court is whether the Petitioner's aviation activities for 2008 - 2010 were conducted with a "for profit" motive. Had the Department audited the Petitioner for a longer period of time or during another time period altogether, the court may or may not have found that he met the requirements of Section 183 of the Internal Revenue Code. The Department is stuck with the audit period it chose despite its aversion to the court's assessment of the evidence presented at the contested case hearing.

[11] This is especially the case at this point in the nation's economic downturn.

[12] In fact, nearly the only point on which the Department was able to effectively bring out in cross-examination of the Petitioner was the Petitioner's admission that he did not secure written approval from the bank before leasing the aircraft. Given the fact that the Petitioner was clearly leasing the plane even if it was in violation of the finance agreement, this admission does not evidence the Petitioner's activities were not for profit in light of all of the evidence.

Department ignores the Petitioner's testimony rendered on his cross-examination that during the audit period, the leases were ongoing but there was no requirement by either business to fly a specific number of hours.

The expertise of the taxpayer or his advisors.

27. According to the regulations, "[p]reparation for the activity by extensive study of its accepted business, economic, and scientific practices, or consultation with those who are expert therein, may indicate that the taxpayer has a profit motive where the taxpayer carries on the activity in accordance with such practices." 26 C.F.R. § 1.183-2(b)(2), Treas. Reg. § 1.183-2(b)(2).

28. Federal regulations require owners to operate under either FAA Part 91 or 135.[13] In addition to that which is outlined under Paragraph 13 above, the Petitioner's unrefuted testimony is that he worked extensively with experienced and knowledgeable advisors and consultants in comparing the benefits and disadvantages of FAA Part 91 and 135. In some instances, the Petitioner did this before he even purchased the Cirrus for several purposes including to determine the proper structure and establishment of his aviation activity. Before making a decision to proceed under FAA Part 91, the Petitioner consulted with the following: Aviation Tax Consultants, LLC; an accountant, Jerry C. Lloyd, CPA; and attorneys. The Petitioner also contacted other companies (including fixed-based operators) who had aircraft and leased them to discuss how they had chosen under which FAA provision to operate and their experiences; in one instance, the Petitioner met with the owner of the company who operated under Part 91 and reviewed and discussed the nuances of both its accounting and business practices. Also prior to purchasing the Cirrus, the Petitioner had leased aircraft under FAA Part 91 for personal and recreational use.

This factor weighs in favor of the Petitioner.

The time and effort expended by the taxpayer in carrying on the activity.

29. According to the regulations, a profit motive may be indicated where the taxpayer either devotes much of his personal time and effort to carrying on the activity, or employs competent and qualified persons to carry on the activity. 26 C.F.R. § 1.183-2(2)(b)(3), Treas. Reg. § 1.183-2(b)(3). There is no requirement that an activity must be a taxpayer's sole or even

[13] While operating under FAA Part 135 allows operators to charter their aircraft to a wider customer base, there are additional compliance, insurance, scheduling, and maintenance costs.

principal occupation in order for it to be considered engaged in for profit. *Christine v. Comm'r*, T.C. Memo 2010-144.[14]

30. The Petitioner expends approximately twenty (20) to thirty (30) hours per month on aircraft activity. Moreover, "[t]he fact that the taxpayer devotes a limited amount of time to an activity does not necessarily indicate a lack of profit motive where the taxpayer employs competent and qualified persons to carry on such activity." *Appley v. Comm'r*, T.C. Memo 1979-433. As discussed above, the Petitioner employed competent professionals, including accountants, who managed his business' books and records. He also placed another pilot for the Cirrus on his insurance policy.

31. Aside from marketing and flying the aircraft, the Petitioner insures the plane is properly maintained and compliant with all regulations. He submits all necessary paperwork associated with the same.

32. In addition, during the end of 2008 and early part of 2009, the Petitioner spent extensive time training in order to obtain the necessary certifications to expand the conditions under which he was authorized to fly. By becoming instrument rated, the Petitioner not only reduced the costs associated with insuring the aircraft (which could enhance profitability) but also, increased its efficiency by twenty-five percent (25%) when the Petitioner was utilizing the aircraft for his orthodontic practice and he was flying it.[15]

33. The Petitioner's ability to fly the plane for business purposes also evidences a "for profit" motive in that if the Petitioner is available to fly the plane when being leased by his practice, there is no need to hire a pilot at a cost of $300.00 to $500.00 per hour.

34. The Petitioner's flight training time also enabled the Petitioner to promote his services to a wider market. The Petitioner testified regarding his communication with Clemson University officials regarding the possibility of the plane being leased for use by Clemson's athletic department.

35. The Petitioner's use of the aircraft cultivated referral sources for his orthodontic practice and facilitated the generation of considerable income for his orthodontic practice. This was unrefuted.

---

[14] 2010 WL 2640125.

[15] There are four (4) seats in the Cirrus aircraft.

36. In its Motion for Reconsideration, the Department argues that the time constraints of the Petitioner's orthodontic practice did not allow for the aviation activity to be conducted for a legitimate profit motive and that the time during which the Petitioner spent on the activity "could not reasonably lead to profit." The court disagrees. The Department's argument is an unveiled attempt to usurp the court's exclusive province to determine the credibility of witnesses, make findings of fact, and determine whether the Petitioner met his burden of proof.

37. The court finds that the Petitioner met his burden of proof as to this factor. Simply because the Department disagrees with the court's determination and the outcome of the case does not serve as an appropriate basis for reconsideration, alteration or modification of an order although in this instance, the court has given the Department's motion due consideration.

Expectation that assets used in activity may appreciate in value.

38. According to the regulations, a *bona fide* expectation that assets used in the activity will appreciate in value may indicate a profit objective. 26 C.F.R. § 1.183.2(b)(4), Treas. Reg. § 1.183-2(b)(4). It is unlikely however, for an airplane to appreciate in value and the Petitioner presented no testimony to the contrary. This factor weighs against the Petitioner.

The success of the taxpayer in carrying on other similar or dissimilar activities.

39. "The fact that the taxpayer has engaged in similar activities in the past and converted them from unprofitable to profitable enterprises may indicate that he is engaged in the present activity for profit, even though the activity is presently unprofitable." 26 C.F.R. § 1.183-2(b)(5), Treas. Reg. § 1.183-2(b)(5). Furthermore, just because the taxpayer is a neophyte with respect to this particular activity, this should not be held against him. *See Smith v. C.I.R.*, T.C. Memo 1997-503.[16]

40. The court is cognizant that the fact that a taxpayer that was successful in other unrelated activities but incurred losses in the challenged activity may be held against the taxpayer. *Gurley v. United States*, 74-1 USTC ¶9311 (D.N.M. 1973).[17] On the other hand, a taxpayer's

---

[16] 1997 WL 695369. *Smith*, involved a vascular surgeon who practiced medicine, leased medical equipment, and operated an agricultural business. The taxpayers, husband and wife, also became involved in dog showing and breeding. In considering the taxpayers' experience in similar or dissimilar activities, the court found this factor in favor of the taxpayers noting the following: (1) the husband operated a successful medical practice; (2) while the farm showed losses during its first three (3) years, it has since been profitable; and (3) the fact that the taxpayers' prior experience may indicate an activity engaged in for profit, the lack of such experience does not necessarily indicate that the activity was not engaged in with the objective of making a profit.

[17] 1973 WL 715. In *Gurley*, the jury was instructed to consider whether activity was conducted with the same efficiency as the taxpayer's other activity.

success in other unrelated activities may also support his profit motive in the challenged activity. *Jasienski v. C.I.R*, T.C. Memo 1992-67.[18]

41. Given the evidence in this case including the Petitioner's credible testimony, and in consideration of the totality of all facts and circumstances, the court finds that the Petitioner has met his burden of proof as to this factor.

42. Here, the Petitioner has grown and developed a significant and successful orthodontic practice. The Petitioner's uncontroverted testimony is that he first entered the practice in 1994. As with the aviation activities, the Petitioner spent time investigating and researching what business model would be best for him to follow. The Petitioner decided to join an existing orthodontic practice. Much like seeking potential lessors for the Cirrus, by contacts and word of mouth, the Petitioner sought out orthodontic practices who may be looking for an associate. Prior to the Petitioner joining the orthodontic practice, it was earning revenues of $600,000 annually with consistent four percent (4%) annual growth over the years. By 1997, the Petitioner had increased the practice's annual revenues to $1,500,000 and by 1999/2000, annual revenues were nearing $2,000,000. The Petitioner increased the practice's profitability so much, he was able to expand its territory including opening a second office; the Petitioner also hired other orthodontists. The court notes that as with the Petitioner's aviation activity, his orthodontic practice was likewise affected by the recession over which the Petitioner had no control.

43. The Petitioner also owns and operates successful residential and commercial real estate operations through CCL. As with the Petitioner's aviation activity, the real estate business conducted through CCL also involves leases. As an aside, prior to the purchase of the Cirrus, the Petitioner had successfully negotiated leases of other aircraft for his business and personal use.

44. Based on the foregoing, even though the Petitioner has not previously specifically engaged in the leasing of his aircraft, the Petitioner has demonstrated success in carrying on both similar (property leasing) and dissimilar (orthodontic) activities. Thus, this factor weighs in favor of the Petitioner.

---

[18] 1192 WL 340742. In *Jasienski*, the taxpayers had no prior experience in operating a limousine service except for an airport shuttle service, an endeavor in which they were successful. They successfully engaged however, in other business activities requiring business acumen and entrepreneurial skill.

The taxpayer's history of income or losses with respect to the activity.

45. While it is undisputed that the Petitioner sustained net losses during the tax periods at issue, startup costs for businesses can frequently exceed revenues during the first years of operation, especially when the business is entitled to substantial depreciation allowances for the purchase of machinery and other property. *See Stanley v. Comm'r*, T.C. Memo 1980-217;[19] *Westphal v. Comm'r*, T.C. Memo 1994-537;[20] and *Upton v. Comm'r*, T.C. Memo 1990-250.[21]

46. Recognizing the likelihood of startup losses, the regulations under Section 183 of the IRC provide that a "series of losses during the initial or startup stage of an activity may not necessarily be an indication that the activity is not engaged in for profit." 26 C.F.R. § 1.183-2(b)(6), Treas. Reg. § 1.183-2(b)(6).

47. A history of startup losses has been viewed as customary in the process of building a profitable business. *See Kimbrough v. Comm'r, T.C. Memo 1988-185*;[22] *Bryant v. Comm'r, T.C. Memo 1989-527*,[23] *aff'd in part, rev'd in part, and rem'd*, 928 F.2d 745 (6th Cir. 1991). In fact, courts have found a profit motive even where losses were sustained during startup periods as long as ten (10) years. *See Nickerson v. Comm'r*, 700 F.2d 402 (7th Cir. 1983). *See also Churchman v. Comm'r*, 68 T.C. 696 (1977).

48. Finally, the regulations clarify that "[i]f losses are sustained because of unforeseen or fortuitous circumstances which are beyond the control of the taxpayer, such as . . . depressed market conditions, such losses would not be an indication that the activity is not engaged in for profit." Id. 26 C.F.R. § 1.183-2(b)(6), Treas. Reg. § 1.183-2(b)(6).

Startup Losses.

49. After beginning his aviation activities late in the 2008 calendar year and experiencing significant losses in large part due to depreciation of the airplane, the Petitioner has steadily increased revenue. In 2010, revenues were sufficient to cover all operational costs (excluding depreciation and interest expense).

50. In its Motion for Reconsideration, the Department has taken issue with the court's consideration of the effect of startup losses of the Petitioner's aviation activity during the first

---

[19] 1980 WL 4063.
[20] 1994 WL 583177.
[21] 1990 WL 66542.
[22] 1988 WL 39787.
[23] 1989 WL 111301.

twenty-seven (27) months of the Petitioner's business operation, and believes that too much emphasis was given to it. However, this court cannot disregard the body of law which discusses the customary nature of startup losses during the first years as a business. The Department's motion not only contradicts, but also belies its own witness' reluctant testimony that the first two (2) years of a business are often its most difficult.

51. In its original order, the court noted that the safe harbor provision of Section 183(d) of the IRC requires a rebuttable presumption of profit where the taxpayer can demonstrate a net profit in at least three (3) or more years in a period of five (5) consecutive years. 26 U.S. Code § 183(d). Thus, the IRC recognizes the need for a longer period during which the profitability analysis should be made. Also in its original order, the court referenced case law which provides that Section 183(d) constitutes a tacit recognition that many businesses are fraught with losses during their startup years and that such losses are quite common. *See Landry v. Comm'r.*, 86 T.C. 1284, 1305 (1986) (*citing Jasionowski v. Comm'r,* 66 T.C. 312, 322 (1976); *Bessenyey v. Comm'r*, 45 T.C. 261, 274 (1965), *affd.* 379 F.2d 252 (2d Cir. 1967).

52. In its Motion for Reconsideration, the Department argues that the Petitioner is not entitled to the safe harbor provisions pursuant to Section 183(d). The original order issued by this court never stated that the Petitioner was entitled to the safe harbor provision as the issue is not before the court.

53. Section 183(d) was mentioned by the court for the sole purpose of noting that while the federal taxing authority believes that a longer period of time during which a profitability analysis should be made, the Department elected to only conduct a three (3) year versus a five (5) year audit period. The court again notes that during the thirty-six (36) month audit period, the Petitioner was only in business for twenty-seven (27) months and during 2008, the Petitioner was only in business for three (3) months.

54. While the Department may audit any period it deems appropriate, it cannot now be heard to complain about the outcome of the case which may in part be a result of the extremely narrow window during which it sought to audit the Petitioner in addition to the timeframe and the manner it chose to defend its determination.[24] Had the Department audited the Petitioner for a

[24] The court notes that counsel for the Department that filed the Motion for Reconsideration was not present at the hearing on this matter. Many of the arguments advanced by the Department's counsel in its motion are based on the Department's opinion of the weight of the evidence and credibility of the witnesses which is within the sole province of the court and will not be disturbed absent an abuse of discretion. *See Wilder v. Blue Ribbon Taxicab Corp.*, 396

longer period of time or during another period altogether, the outcome may have been completely different.[25]

The Recession.

55. The Petitioner's purchase of the Cirrus occurred during a great recession and partially in response to Congress' attempt to stimulate the economy.

56. During the depths of the recent national economic downturn, Congress implemented additional depreciation allowances for businesses making certain purchases of property under the Economic Stimulus Act of 2008. *See* P.L. 110-185, § 103. Subsection (k) of IRC § 168 was amended to allow a fifty-percent (50%) bonus depreciation if the property was placed into service in 2008. 26 U.S.C.A. § 183.

57. The legislative history of the Act reveals that the Act was passed to stimulate the economy and encourage capital purchases. Upon signing the bill, President George W. Bush remarked on February 13, 2008 that it "provide[d] temporary tax incentives for businesses to make investments in their companies so that we create new jobs this year."[26]

58. Additionally, a press release issued from the White House that day remarked:

> ***This legislation also offers incentives to spur business investment.*** The legislation would save businesses approximately $50 billion in near-term taxes through a temporary change to the tax code that will allow American businesses that buy new equipment this year to deduct an additional 50 percent of the cost of their investment in 2008. This will encourage businesses to expand and create new jobs now because buying equipment, software, and tangible property this year will dramatically lower their taxes.[27]

(emphasis in original).

S.C. 139, 719 S.E.2d 703 (Ct. App. 2011) (the credibility and weight to be accorded to evidence is solely for the fact finder and will not be reversed on appeal absent an abuse of discretion).

[25] The Petitioner testified extensively regarding the factors utilized in determining whether his aviation activity qualified as a business for profit and the vast majority of his testimony was not impeached although the Department's auditor may have had differing opinions. The Department's Motion for Reconsideration essentially questions this court's determination as to the credibility of the witnesses and the weight to be assigned to the evidence in this case. Given the Department's ineffective cross-examination of the Petitioner combined with its like examination of its unprepared witness (who rushed through her testimony so she would be able to make it in time for her husband's graduation), the evidence presented by the Petitioner carried far more weight and was more credible.

[26] This quote can be found in the Public Papers of the Presidents of the United States, George W. Bush, 2008-2009, Book I-January 1 to June 30, 2008 at 180.

[27] This quote can be found in the following White House Fact Sheet and press release: White House Fact Sheet: Bipartisan Growth Will Help Protect Our Nation's Economic Health, Office of the Press Secretary, February 13, 2008.

59. The Tax Court has recognized the effect of congressional efforts to encourage certain behavior from taxpayers, and has found that requiring a taxpayer to prove his principal purpose was to generate pre-tax profits would seriously undermine congressional efforts to stimulate activity by enacting special tax subsidies. *See Fox v. Comm'r*, 82 T.C. 1001 (1984). The *Fox* court relaxed its rule "to allow for those essentially tax-motivated transactions which are unmistakably within the contemplation of congressional intent." *Id* at 1021. The determination of whether Congress intended to encourage a particular activity requires "a broad view of the relevant statutory framework and some investigation into legislative history." *Id* at 1021. Aside from those activities specifically identified by the *Fox* court (non-recognition of gain on the sale of low-income housing and industrial development bonds)[28], other activities include (1) purchases of property motivated, in part, by accelerated depreciation, deductible interest, and the investment tax credit; (2) deductible interest; (3) renovation of historic structures; (4) purchase of tax-exempt securities. *See Fox*, 82 T.C. at 1021.

60. It is inconsistent for Congress to induce taxpayers to undertake a variety of activities it deems advisable and beneficial to the economy as a whole, but then have taxing authorities prevent those taxpayers who undertake those activities from claiming losses that may result from engaging in those desired activities. *See Baron Est. v. Comm'r.*, 83 T.C. 542 (1984), *aff'd*, 798 F.2d 65 (2d Cir. 1986) (when determining whether taxpayer had necessary profit motive, "our intermediate position will permit accommodation, as a mechanical rule would not, in those areas where Congress has singled out particular transactions for favorable treatment via tax-benefit subsidies").

61. However, the applicability of and whether the Petitioner is entitled to deductions pursuant Section 168 is not before this court. Its relevance to this case and the issues before this court is that it constitutes recognition by Congress of the recession that occurred at the time that the Petitioner purchased the Cirrus and commenced business. Irrespective of the Petitioner's belief as to applicability of the tax incentives which served as part of his motivation in purchasing the Cirrus, the Petitioner testified to multiple other sufficient reasons for his purchase of the Cirrus.

62. In its Motion for Reconsideration, the Department argues its opinion that the Petitioner's testimony about the downturn in the economy is "highly suspect," and states that the Petitioner presented no evidence that he consulted anyone for a recession resistant plan. This

[28] *See e.g.*, 26 U.S.C.A. §§ 103 (b); 26 U.S.C.A.1039 (b)(1) (repealed in 1990).

appears to be the Department's post-hearing assessment as to the court's determination as to the credibility of the witnesses and the weight to be assigned to that evidence

63. While the Department argues that the Petitioner presented no evidence that he consulted with anyone regarding a recession resistant plan, the Petitioner was only in business twenty-seven (27) months of the three (3) year audit period. Such a short period of time barely gave the Petitioner sufficient time to evaluate his business model or change it.

64. Further, although the Petitioner strategically timed the purchase and startup of his business with the airplane manufacturer's expansive "Flying 2.0" program, the downturn in the economy commencing in 2008, the same year the Petitioner started his business, certainly affected the attractiveness and popularity of non-commercial flying. These depressed market conditions were beyond the control of the Petitioner.

65. Tax courts have acknowledged the impact of the recession. *See Metz v. C.I.R.*, T.C. Memo 2015-54[29] (referencing 2008, the tax court stated "the bottom fell out of the economy that fall, and the Great Recession depressed the demand for …").

66. More importantly, while the 2008 – 2009 recession is not a legislative fact, federal courts have taken judicial notice of it as an adjudicative fact. *See, e.g., Eclectic Properties East, LLC v. Marcus & Millchap Co.*, 751 F.3d at 998, note 6 (9th Cir. 2014).

67. In its Motion for Reconsideration, the Department opines that the court placed too much emphasis on the recession. Interestingly, the Department neglected to take the depressed market conditions into account, or even acknowledge that the economy suffered a recession during the periods at issue. On cross-examination, the Department's auditor was extremely evasive when asked whether a recession occurred in 2009 and refused to voluntarily answer the question directly. Only after repeated requests by the Petitioner over the Department's objection, and the court's statement that the auditor had not answered the question, the auditor conceded that during 2008, 2009 and 2010 the country had "economic issues." She then conceded that while analyzing the taxpayer's history of income or losses with respect to the activity, the Department did not apply or even consider, unforeseen or fortuitous circumstances such as depressed market conditions. Upon further cross-examination, the auditor finally admitted that (1) in years of "economic issues," people tend to cut back on discretionary spending; and (2) airline charters involve discretionary spending.

---

[29] 2015 WL 1285276.

68. Not until its Motion for Reconsideration does the Department acknowledge "... there is no question that an economic recession did occur and the [Petitioner's] aviation activities were probably affected ..." and this post-hearing acknowledgement is offered solely to support the Department new argument in which it claims for the first time that the Petitioner should have known how badly the Great Recession was at the time he purchased the Cirrus and how it would affect any for-profit use of the plane. The Department presented no evidence whatsoever of this at the hearing and the court declines to draw such inference now.

69. The Department states that it insisted at the hearing that the Petitioner produce credible evidence regarding the recession. The court interprets the record differently. The Petitioner's counsel attempted to solicit the Petitioner's opinion as to the recession's effect on discretionary spending including airline charters. The Department objected. The court sustained the Department's objection holding that the Petitioner (who had privately chartered planes, had an orthodontic practice and his own charter business), could not give his opinion about the impact of the recession on *other* businesses. In fact, Rule 701 of the South Carolina Rules of Evidence provides in part that if a witness is not testifying as an expert, the witness' testimony in the form of opinions or inferences is permitted but limited to those opinions or inferences which are rationally based on the perception of the witness, and are helpful to a clear understanding of the witness' testimony or the determination of a fact in issue. Rule 701, SCRCP.

70. Aside from the fact that the Petitioner has not sustained a long period of losses, as outlined above, he had a more than adequate explanation as to why even these short term losses were sustained by unforeseen circumstances beyond his control. This factor weighs in favor of the Petitioner.

Profits actually earned and possibility of ultimate profit.

71. According to the regulations, "[t]he amount of profits in relation to the amount of losses incurred, and in relation to the amount of the taxpayer's investment and the value of the assets used in the activity, may provide useful criteria in determining the taxpayer's intent." 26 C.F.R. § 1.183-2(b)(7), Treas. Reg. § 1.183-2(b)(7). In this case, although the Petitioner depreciated the cost of the aircraft during the periods at issue, the depreciation is limited by statute to seven (7) years. Without taking depreciation and interest expense into account, the Petitioner would have generated an actual profit in 2010. This analysis demonstrates that there is a potential

for ultimate profit given the positively-trending income from 2008 until 2010, and acknowledging that depreciation is limited. Thus, this factor weighs in favor of the Petitioner.[30]

72. At the contested case hearing, the Petitioner testified that in 2013, the business earned a profit. The court sustained the Department's objection to this testimony as it was outside of the scope of the years for which the Department conducted its audit even though it has been argued that excluding tax years before and after those in issue can lead to overly severe results. In response to the Department's Motion for Reconsideration, the court reiterates however, that it limited its review to the tax years at issue.

The financial status of the taxpayer.

73. According to the regulations, "... Substantial income from sources other than the activity (particularly if the losses from the activity generate substantial tax benefits) may indicate that the activity is not engaged in for profit...." 26 C.F.R. § 1.183-2(b)(8), Treas. Reg. § 1.183-2(b)(8). However, as stated in Tax Management Portfolio No. 548-2nd: Hobby Losses, at p. A-33,[31] the financial status of the taxpayer "must be viewed in light of all the other pertinent facts [and] circumstances, i.e., just because a taxpayer is wealthy, it does not necessary follow that every activity he undertakes will lack a profit motive." *See Appley v. Comm'r*, 1979-433 (1979);[32] *Faulconer v. Comm'r*, 748 F.2d 890 (4th Cir. 1984); *Frazier v. Comm'r*, T.C. Memo 1985-61;[33] *Harrison v. Comm'r*, T.C. Memo 1996-509;[34] *Hellings v. Comm'r*, T.C. Memo 1994-24.[35] Moreover, the Tax Court has criticized the idea that a loss should be denied simply because it is otherwise offsetting other income. *Engdahl v. Comm'r*, 72 T.C. 659, 670 (1979).

74. The Petitioner presented unrefuted evidence at the hearing that he generates substantial income from other business pursuits including his orthodontic practice and his real estate business. This fact does not preclude him from engaging in activities for profit especially given all of surrounding circumstances including but not limited to the manner in which the activity was carried out (e.g., diligent investigation, consultation with experts, maintenance of accurate records, carrying on in a businesslike manner) and others discussed above. This factor weighs in the Petitioner's favor.

---

[30] The court also finds that the Petitioner's expectation of profit was objectively realistic.
[31] This is a publication of Bloomberg BNA.
[32] 1979 WL 3478.
[33] 1985 WL 14694.
[34] 1996 WL 659361.
[35] 1994 WL 17916.

- **Elements of personal pleasure or recreation.**

75. The regulations provide that "[t]he presence of personal motives in carrying on of an activity may indicate that the activity is not engaged in for profit, especially where there are recreational or personal elements involved." 26 C.F.R. § 1.183-2(b)(9), Treas. Reg. § 1.183-2(b)(9). However, a legitimate, for-profit business does not become a hobby merely because the taxpayer finds the activity pleasurable. *Jackson v. Comm'r*, 59 T.C. 312 (1972).

76. Using the Cirrus for pleasure was not a consideration prior to its purchase as the Petitioner already had other aircraft at his disposal for this purpose. During the audit period, the Petitioner owned three (3) ultralight planes, all of which were flown for personal and recreational use. Each plane allowed for the pilot and one (1) passenger. The Petitioner testified that he purchased these planes personally and did not depreciate them. He also testified that these planes were not designed to be flown in inclement weather. Two (2) of the planes had open-air cockpits and utilizing the SportCruiser in bad weather would not have been prudent. This was uncontroverted.

77. At the hearing, the Petitioner detailed the onerous requirements associated with putting the Cirrus aircraft into flight including the pre-flight details such as flight plans and permission from other airports to taxi. The paperwork and additional steps associated with flying the Cirrus are much more onerous. The Petitioner testified that flying the Cirrus is not enjoyable for him based on the additional requirements needed to operate the plane which are not found in the flying of ultra-light aircraft. Because of its complexity, speed and maneuverability, flying the Cirrus is much more intense and stressful.

78. While the Petitioner may find gratification in the act of flying, it does not follow that the business of providing a pilot or a plane to paying customers also brings pleasure. Moreover, with the exception of one (1) trip to Maryland which occurred when the plane that the Petitioner had leased for personal and recreational use was not available, the Petitioner never used the Cirrus for personal travel or recreation according to his log books. In fact, the Petitioner's children have never flown in the Cirrus. Based on the foregoing, this factor weighs in favor of the Petitioner.

- ***Consideration of the Petitioner's Entire Economic Relationship and its Consequences When Determining Whether Aviation Activities are Engaged in for Profit***

79. At the contested case hearing, the Petitioner argued that the court should consider the Petitioner's entire economic relationship in determining his profit intent. Some courts have permitted taxpayers to establish their own profit intent by including the profit objectives of related entities. *See Campbell v. Commissioner*, 868 F.2d 833 (6th Cir. 1989). While this court finds that based on the analysis above and standing alone, the Petitioner's aviation activities in which he engaged overwhelming indicate that they were for profit, the Petitioner's case is further strengthened by taking his entire economic relationship into account.[36]

80. In *Campbell*, the Sixth Circuit reversed a Tax Court finding that a partnership which owned an airplane and leased it to related corporations was not engaged in an activity for profit. In *Campbell*, the taxpayer was a practicing psychiatrist who also was a shareholder in a corporation formed to invest in and develop health care facilities. *Id.* at 835. Recognizing the need for air transportation both for the corporate officers and the general public, the corporation's shareholders formed a partnership and purchased an airplane. *Id.* The partnership then leased the plane to the corporation and attempted to market the plane by word of mouth. *Id.* Despite the advertising, the vast majority of the use was limited to the corporation. *Id.*

81. During the four (4) years at issue, the partnership in *Campbell* reported close to $600,000 in losses and the partners reported their distributive share of those losses. *Id.* at 836. On audit, the IRS disallowed the taxpayer-partners' losses after determining the aviation activities were not engaged in for profit. The Tax Court agreed, finding the "sole motivation of the partnership for engaging in the airplane leasing activity was to provide [the corporation] with air transportation while at the same time generating paper losses for the [partners] to offset their substantial incomes." *Id.*

82. The Sixth Circuit Court of Appeals reversed the Tax Court and found for the taxpayer. The Sixth Circuit noted that the Tax Court "overlooked the numerous authorities holding that an individual may arrange his affairs in order to use his assets to make a profit in a corporation and that such economic arrangements do not require an 'either-one-or-the-other' profit motive." *Id* at 836. Instead of looking at the motive of just the airplane leasing activity, the Sixth Circuit

[36] In its Motion for Rehearing, the Department argued that the Petitioner convinced the court to take into account, the income of the Petitioner's wife's car dealership. In this Amended Final Order and Decision, the court has not considered the benefit or income derived by the Petitioner's wife's automobile dealership.

found that "[t]he *entire economic relationship and its consequences* are what determine profit motive" *Id.* at 836-37 (emphasis added).

83. The Sixth Circuit relied on *Horner v. Comm'r*, 35 T.C. 231 (1960) for the proposition that a taxpayer may include the profit objectives of related entities in establishing his own profit motive. In *Horner*, the taxpayer who served as president and general manager of a corporation, bought goods as an individual (using his personal line of credit) that were intended to be resold by his corporation. *Id.* After the corporation became insolvent, the taxpayer was required to pay the balance due on the goods which were transferred to the corporation. The Tax Court found that the taxpayer had a profit motive necessary to deduct a loss under IRC § 165(c)(2) because "the expectation was that the profits would come to [the taxpayer] either as salary as president and general manager, from dividends on his stock, or as an increase in the value of his stock." *Id.* at 236.

84. The Sixth Circuit in *Campbell* also took issue with the IRS' desire to tax the profits of the corporation, which were increased due to the efficiencies provided by the plane, yet disallow the deductions related to the use of that plane. It noted:

> The Internal Revenue Service argues that since the partnership as an entity was not a [corporate] shareholder and could not directly receive the benefits of [corporate] dividends, salaries, or increased stock value, the increased profitability of [the corporation] could not evidence a partnership profit motive. This argument makes a distinction without a difference. A general partnership . . . is organized in such a way that any benefits or profits realized by the general partnership automatically pass through to the . . . partners. Any contemplated increase in wealth for the group of [corporate] stockholders acting in partnership is an increase in wealth of the individuals. This increase, which was presumably taxed in due course, was accomplished through the use of transportation and communication efficiencies provided by the partnership airplane. The IRS would tax the profits and capital gains from the corporation—gains attributable in part from the use of the airplane—while denying deductions to the stockholder-partners attributable to the use of the airplane.

Campbell at 837. In short, the Sixth Court found that because the airplane increased the profits of, and thus the tax paid by the related corporation, the airplane activity should be considered engaged in for profit.

85. As did the Sixth Circuit did in *Campbell*, this court may also consider the entire economic relationship and its consequences when determining whether the Petitioner has a profit motive with respect to his aviation activities. Here, the Petitioner relies on the aviation services provided by the single-member CCL, LLC in order to provide the efficiency required to run a successful orthodontics practice, a real estate business, and pursue other business ventures (including the potential purchase of automotive dealerships). Because the Petitioner's orthodontic practice relies almost exclusively on referrals from other dentists across the southeast, it is vital that he attend regional networking functions.

86. The IRS will accept a taxpayer's characterization unless the characterization is "artificial and cannot be reasonably supported under the facts and circumstances of the case." 26 C.F.R. § 1.183-1(d)(1), Treas. Reg. 1.183-1(d)(1). "Generally, the most significant facts and circumstances in making this determination are the degree of organizational and economic relationship of various undertakings, the business purpose which is (or might be) served by carrying on the various undertakings separately or together in a trade or business or in an investment setting, and the similarity of various undertakings." *Id.*

According to one commentator:

> As a general proposition, the IRS will accept the taxpayer's characterization of several endeavors as a single activity or multiple activities, so long as the facts and circumstances bear out the characterization.
>
> *Topping v. Commissioner*,[37] considered this single/multiple activity dilemma. The taxpayer engaged in horse activities such as attending horse shows and participating in equestrian events. The taxpayer's horse-related activities also included design activities such as interior design of clients' homes and designing their horse barns. For the 1999-2001 tax years, the taxpayer's accountant filed separate Schedule C for the horse and design activities....
>
> The IRS assessed a deficiency against the taxpayer for the 1999-2001 tax years (when separate Schedules C were filed) on the basis that the horse activity was not engaged in for profit. The Tax Court focused on whether § 183(a) should limit the taxpayer's deductions for the horse activities, on the basis of no profit motive. The taxpayer presented evidence that she catered to an elite clientele in the equestrian circuit, who viewed traditional advertising as tacky or

[37] *Topping v. Comm'r*, T.C. Memo 2007-92. This memo can be also located at 2007 WL 1135339.

> gauche. Thus, the taxpayer primarily developed clients through her participation in equestrian events....

Tax Management Portfolio No. 548-2nd: Hobby Losses, at p. A-18 (citations omitted). Based on the above, the Tax Court in *Topping* determined that the taxpayer's horse and design activities constituted a single activity, even though the taxpayer's accountant had previously reported those activities on separate Schedule Cs.

87. Other factors relevant to the characterization of several undertakings as a single activity include: whether the undertakings share a close organizational relationship; whether one undertaking benefits from the other; whether the taxpayer used one undertaking to advertise the other; the degree to which the undertakings shared management; and whether the taxpayers used the same accountant for the undertakings. *See, e.g., Keanini v. Comm'r*, 94 T.C. 41 (1990); *Hoyle v. Comm'r*, T.C. Memo 1994-592;[38] *De Mendoza v. Comm'r*, T.C. Memo 1994-314;[39] *Scheidt v. Comm'r*, T.C. Memo 1992-9.[40]

88. Like the taxpayers in *Campbell* and *Topping*, the Petitioner's aviation activities should be combined with all of his businesses and business ventures when determining whether they were engaged in for profit. The aviation activities were operated under a single member LLC, of which the Petitioner was that sole member, and it also contained the Petitioner's rental property activities. The Petitioner's orthodontic practice was operated under a separate wholly-owned S-Corporation of which he was the sole shareholder. Both of these were pass-through entities, meaning those entities were for purposes of tax reporting and liability.

89. The operation of the aircraft benefitted the orthodontics practice by allowing the Petitioner to generate and increase new referrals, to look at new and innovative equipment and technologies to incorporate into the practice and to efficiently attending continuing education classes. It also benefitted his real estate business and facilitated the effective investigation of other business ventures. Additionally, the Petitioner's rental property, orthodontics, and aviation activities shared management of the Petitioner and his staff.

---

[38] 1994 WL 675565.
[39] 1994 WL 320875.
[40] 1992 WL 810.

90. Taking only the Petitioner's activities[41] into account, the Petitioner actually generated a profit during the periods at issue when his entire combined economic relationship is considered. In his worst year during the periods at issue, the Petitioner's net taxable income exceeded $360,000. Based on the forgoing including the profitability of the Petitioner's business operations, this court finds that those activities were engaged in for profit.

ORDER

Based upon the foregoing Findings of Fact and Conclusions of Law,

IT IS HEREBY ORDERED that the court finds that the Petitioner engaged in aviation activities for profit for the periods at issue.

AND IT IS SO ORDERED.

S. Phillip Lenski
Administrative Law Judge

January 22, 2016
Columbia, South Carolina

CERTIFICATE OF SERVICE
This is to certify that the undersigned has this date served this order in the above entitled action upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, or in the Interagency Mail Service addressed to the party(ies) or their attorney(s).

This 22d day of JAN 2016

By: _____
Judicial Law Clerk

[41] While not relevant to the court's decision in this case as it was not considered, at the contested case hearing, the Petitioner was permitted to extensively testify regarding how his wife's automotive dealership benefitted from the Cirrus without any objection by the Department.