US-DIST-CT, **[97-2 USTC ¶50,936]**, U.S. District Court, Dist. N.D., Northwestern Div., **Thomas Kenvill, Plaintiff v. United States of America, Defendant** , **Passive activity losses: Plane charter activity: Rental activity: Exceptions: Available to customers: Exclusive**, (Nov. 06, 1997)

[97-2 USTC ¶50,936] Thomas Kenvill, Plaintiff v. United States of America, Defendant U.S. District Court, Dist. N.D., Northwestern Div., Civ. A3-96-134, 11/6/97

[*Code Sec. 469*]

Passive activity losses: Plane charter activity: Rental activity: Exceptions: Available to customers: Exclusive use: Consulting business: Incidental to extraordinary personal services.--The IRS was granted partial summary judgment regarding whether a sole proprietor was entitled to a passive activity loss deduction with respect to his plane charter activities. Although the taxpayer's plane was made available during business hours to any customer who wanted to lease it, chartering the plane gave the customer exclusive use of the plane for the duration of the charter. Thus, the taxpayer did not qualify for the Reg. §1.469-1T(e)(3) (ii)(E) exception to the general definition of rental activity because his customers did not have nonexclusive use of the plane. However, questions of material fact existed regarding what portion, if any, of the charter activity was ancillary to the taxpayer's consulting business and, thus, was exempt from the definition of rental activity as incidental to extraordinary personal services under Reg. §1.469-1T(e)(3) (ii)(C). BACK REFERENCES: ¶21,966.568 .

MEMORANDUM AND ORDER

KLEIN, Magistrate Judge:

Plaintiff Thomas Kenville filed this action pursuant to 26 U.S.C. §7422 claiming he is entitled to a federal income tax refund in the amount of $7,435.80, plus interest, for tax year 1991. (doc. #1.) Plaintiff asserts that the Internal Revenue Service (IRS) improperly disallowed a deduction taken on his 1991 personal income tax return as a "passive activity loss" under I.R.C. (26 U.S.C.) §469. Currently before the court is defendant United States' motion for summary judgment. (doc. #10.) For the reasons stated in this memorandum, the court grants defendant's motion in part and denies defendant's motion in part.

I. Background

Prior to and throughout 1991, Plaintiff operated C.F. Aviation, a sole proprietorship, in Fargo, N.D. During 1991, C.F. Aviation owned a Piper Seneca II airplane. From prior to January 1991 through March or April 1991, C.F. Aviation leased the plane to Spectrum Aviation, Fargo, N.D. Under the terms of the lease, Spectrum Aviation would pay C.F. Aviation $140 per flight hour and could sublease the plane for charter flights. C.F. Aviation was responsible for all operating costs and registration fees. During the term of the lease, Spectrum Aviation did sublease the plane to customers for charter services, which resulted in $19,909.40 of income for C.F. Aviation.

Beginning in May 1991, after its lease with Spectrum Aviation had terminated, through the

end of 1991, C.F. Aviation leased the plane to American Check Transport/Flight Line, Inc. (ACT/FL) out of Denver, Colorado. Under this lease, ACT/FL paid C.F. Aviation $70 per flight hour and also could sublease the plane for charter services. C.F. Aviation was responsible for insurance, maintenance, repairs and registration fees. During the ACT/FL lease the plane was in Denver. ACT/FL did sublease the plane for charter services, producing $30,366.00 of income for C.F. Aviation in 1991.

Plaintiff does not dispute any of the above facts. (doc. #12 (defendant's statement of undisputed facts); doc. #15 (pl. aff.)) However, plaintiff asserts that neither of the above-mentioned leases were exclusive and C.F. Aviation was free to, and in fact did, lease its plane to other parties for charter flights, which plaintiff piloted himself. (doc. #15.)

Furthermore, during 1991 plaintiff also operated another sole proprietorship, Kenville Consulting. (*Id.*) Plaintiff claims that the consulting services he provided would often require the use of his plane for tours of the area. (*Id.*) Thus, plaintiff alleges many of the charters flown by him were incidental to the consulting services he provided. (*Id.*) Plaintiff states that payments for the charter flights provided as part of the consulting services were made to either C.F. Aviation or Kenville Consulting. (*Id.*) Plaintiff further claims that the billing procedures were dictated by Part 135 of the FAA regulations.

Plaintiff and his wife filed a joint federal income tax return for the tax year 1991. On Schedule C of that return, plaintiff recorded a business loss of $33,298.00 for C.F. Aviation. Because of that loss, plaintiff claimed a business loss deduction of $29,999 on Form 1040. The IRS disallowed the deduction, stating that the loss was from a passive rental activity and therefore cannot be deducted from non-passive income under I.R.C. §469. Plaintiff claims that the activities of C.F. Aviation fall under two exceptions to §469 and thus should not be considered a passive rental activity. *See* Treas. Reg. (26 C.F.R.) §1.469-1T(e)(ii)(C), (E).

II. Summary Judgment Standard

Summary judgment is appropriate if there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. Pro. 56(c); *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). Rule 56 of the Federal Rules of Civil Procedure "mandates the entry of summary judgment . . . against a party failing to make a showing sufficient to establish the existence of an element essential to that party's case." *Celotex*, 477 U.S. at 322. If the moving party has supported its motion for summary judgment, the nonmoving party has an affirmative burden placed on it to go beyond the pleadings and show a genuine triable issue of fact. *Commercial Union Ins. Co. v. Schmidt*, 967 F.2d 270, 271 (8th Cir. 1992). However, the court considering a motion for summary judgment must view the evidence in the light most favorable to the nonmoving party who enjoys "the benefit of all reasonable inferences to be drawn from the facts." *Vacca v. Viacom Broadcasting of Missouri. Inc. et al.*, 875 F.2d 1337, 1339 (8th Cir. 1989) (citation omitted).

Summary judgment is improper if the court finds a genuine issue of material fact; however, "the mere existence of some alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment. . . ." *Commercial Union Insurance*

Co. v. Schmidt, 967 F.2d 270, 271-72 (8th Cir. 1992) (citation omitted). The issue is whether the evidence submitted presents a sufficient disagreement about the material facts so that submission, to a jury is required, or whether the evidence is so one-sided that one party must prevail as a matter of law. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 251-52 (1986).

III. Discussion

I.R.C. §469(a) disallows deductions for passive activity losses by individual taxpayers. *See also* Treas. Reg. §1.469-1T(a). Section 469(c)(2) provides that the definition of passive activity includes any rental activity. Furthermore, Treas. Reg. §1.469-1T(e)(3) defines rental activity as any activity involving the use of tangible property by customers where the gross income of the activity is attributable to amounts paid principally for the use of such property. Defendant contends that the charter activities of C.F. Aviation fall squarely within this definition, and thus are non-deductible passive activity losses. (doc. #11.)

Plaintiff does not dispute that the charter activities of C.F. Aviation meet the definition of rental activities in §1.469-1T(e)(3). (doc. #13.) However, Treas. Reg. §1.469-1T(e)(3)(ii) contains several exceptions to the general definition of rental activity that describe certain uses of tangible personal property which are not considered rental activities. Plaintiff contends that the airplane charter activities of C.F. Aviation fall under two of these exceptions: §§1.469-1T(e)(3)(ii)(C) and (E). (doc. #13.)

A. *Section 1.469-1T(e)(3)(ii)(E)*

Treas. Reg. §1.469-1T(e)(3)(ii)(E) provides that an activity involving the use of property will not constitute rental activity if "[t]he taxpayer customarily makes the property available during defined business hours for nonexclusive use by various customers." The regulations illustrate this exception by providing the example of a golf course. *Id.* §1.469-1T(e)(3)(viii) (Example 10). Although golfers pay a fee for the use of the course, because the course is made available to all customers during business hours for nonexclusive use, such activity is not considered rental activity under §1.469-1T(e)(3)(ii)(E).

Plaintiff asserts that because his airplane was made available during business hours to any customer who wanted to charter it, not just Spectrum Aviation and ACT/FL, C.F. Aviation's lease of the plane does not constitute rental activity under §1.469-1T(e)(3)(ii)(E). (doc. #13.) However, §1.469-1T(e)(3)(ii)(E) also requires that the property be made available for *nonexclusive* use by customers. Chartering an airplane gives that particular customer *exclusive* use of the plane during the time the customer is using the plane, similar to renting a car. Chartering an airplane is not analogous to "renting" use of a golf course, where many people are using the same property at the same time. Therefore, because C.F. Aviation's airplane could not have been used nonexclusively by its customers, §1.469-1T(e)(3)(ii)(E) does not apply and defendant is entitled to judgment as a matter of law on this issue.

B. *Section 1.469-1T(e)(3)(ii)(C)*

Section 1.469-1T(e)(3)(ii)(C) provides that if "[e]xtraordinary personal services . . . are provided

by or on behalf of the owner of the property in connection with making such property available for use by customers," the use of the property by customers is not considered a rental activity. Section 1.469-1T(e)(3)(v) goes on to define "extraordinary personal services" as services performed by the property owner or on its behalf in connection with customers' use of the property where the customers' use of the property is "incidental to their receipt of such services." For example:

> the use by patients of a hospital's boarding facilities generally is incidental to their receipt of the personal services of the hospital's medical and nursing staff. Similarly, the use by students of a boarding school's dormitories generally is incidental to their receipt of the personal services provided by the school's teaching staff.

§1.469-1T(e)(3)(v).

Plaintiff alleges that many of the charters of his airplane were connected to the consulting services he provided through Kenville Consulting. (doc. #15.) Plaintiff argues that because his customers were paying primarily for his consulting services, these charter flights were incidental to the consulting services. (doc. #13.) Thus, plaintiff contends that extraordinary personal services were provided in connection with the use of the plane and therefore these charters do not constitute rental activity under §1.469-1T(e)(3)(ii)(C).

Defendant counters plaintiff's argument by asserting that since the only sources of income from charter activity reported for C.F. Aviation were amounts from the leases with Spectrum Aviation and ACT/FL, plaintiff must show that he provided extraordinary personal services to Spectrum Aviation and ACT/FL in connection with the two lease agreements, which plaintiff has not done. (doc. #11.) However, plaintiff alleges that payments for the charter flights he flew in connection with his consulting services were in fact made to either C.F. Aviation or Kenville Consulting. (doc. #15.) Furthermore, plaintiff contends that the billings for these charters were dictated by FAA regulations. (*Id.*) This infers that although on paper all charter flights were billed through Spectrum Aviation in order to comply with the FAA regulations, some payments were in fact made directly to C.F. Aviation or Kenville Consulting and were incidental to consulting services provided by plantiff. Thus, it appears that at least some of the charter flights billed through Spectrum Aviation may have been incidental to plaintiff's consulting business, although the exact amounts attributable to these flights remains to be determined. If that is the case, these particular charter flights would fall under §1.469-1T(e)(3)(ii)(C). However, any revenue from charter flights flown by Spectrum Aviation for its customers could not be considered incidental to plaintiff's consulting services and, therefore, would not fall under §1.469-1T(e)(3)(ii)(C).

Defendant also argues that even if some of the charter flights were incidental to plaintiff's services provided through Kenville Consulting, since C.F. Aviation did not provide the consulting services, these services cannot be considered incidental to the use of the plane, which was provided by C.F. Aviation. However, because sole proprietorships are not considered separate legal entities from the owner, it is irrelevant which entity provided what service. *See* I.R.C. §7701(a)(1) (defining "person" as "an individual, a trust, estate, partnership, association, company or corporation.") Both entities were owned by plaintiff, so whether the services were

provided through C.F. Aviation or Kenville Consulting, they were in fact provided by plaintiff.

Viewing the facts in a light favorable to the plaintiff as the non-moving party, and taking all inferences in his favor, a fact question remains as to whether some of the charter activity of C.F. Aviation may be incidental to extraordinary personal services provided by plaintiff, i.e. consulting services, and thus fall under §1.469-1T(e)(3)(ii)(C). Furthermore, a fact question remains regarding what amount of revenue can be considered incidental to plaintiff's consulting services and what amount is merely passive rental income. Therefore, because fact questions remain regarding the applicability of §1.469-1T(e)(3)(ii)(C) in this case, summary judgment is inappropriate and defendant's motion as to this issue is denied.

IT IS ORDERED:

That defendant's motion for summary judgment (doc. #10) be **granted** with respect to the applicability of §1.469-1T(e)(3)(ii)(E) and **denied** with respect to §1.469-1T(e)(3)(ii)(C).