

Phister Corporation

Phister Corporation has its principal place of business in Arizona. Phister's president and vice president are Dwight Phister (Dwight) and Perry Phister (Perry), respectively. Phister is principally engaged in the retail lumber business with outlets located in eight Louisiana cities. In addition to the retail lumber business, Phister owns a 1976 Model 25 Lear Jet, which was used for travel related to the lumber business and for its air charter service business operated out of Tucson. Dwight and Perry also used the plane for travel related to their positions as directors of other businesses (director's flights), for other business and charitable purposes (nonvacation flights), and for vacation travel (vacation flights). In 1996, the plane was used approximately 30 percent for charter business, 23 percent for director's flights, 18 percent for nonvacation flights, 24 percent for vacation flights, and 5 percent for other purposes. In 1997, the plane was used approximately 16 percent of the time for charter business, 16 percent for director's flights, 32 percent for nonvacation flights, 24 percent for vacation flights, and 11 percent for other purposes.

Dwight and Perry reported use of the aircraft for director's flights, nonvacation flights, and vacation flights as compensation in connection with their employment. The Corporation calculated and reported the amount of imputed income for Dwight and Perry in accord with the valuation formula provided in section 1.61-21(g), Income Tax Regs. and in accord with section 162, deducted its costs incurred in operating the aircraft, including those flights taken for director's flights, nonvacation flights, and vacation flights.

The IRS determined income tax deficiencies of \$341,631 and \$119,558 for petitioner's 1996 and 1997 tax years, respectively. The deficiency determinations were based on adjustments to deductions involving but not limited to airplane expenses. The IRS contends that the deductions for vacation flights are limited to the value of the benefit received by the employee. The IRS agreed that the company is entitled to deduct the expenses for operating the aircraft for flights attributable to the lumber business, the air charter business, the nonvacation flights and the director's flights and agrees that Phister's application of the formula with regard to these expenses is correct.

Required:

Provide Phister Corporation with a response to the IRS regarding the deductible expenses for the vacation flights.