AIRCRAFT TRANSACTION BASICS
A Business Development Opportunity

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I. INTRODUCTION

This paper will describe the basics of aircraft transactions, including aircraft sale, purchase and ownership issues and how current aviation practitioners can expand their practice area to include aircraft transactions, pull in additional work from existing clients and new work from referrals and new clients.

The transactional portion of the paper will cover the basic issues, including FAA registration and aircraft ownership options as well as the common mistake of Part 91 non-commercial operations by single purpose "Flight Department Companies" formed for liability protection. An overview of basic tax considerations, including state sales/use tax, local property tax and federal tax provisions, will be presented so that the practitioner can "issue spot" tax considerations.

The business development portion will explore how to identify resources available to the aviation practitioner, including specialists in and outside the law firm, various aviation organizations and their respective conferences, and outside written publications. An emphasis will be given to developing relationships with aircraft brokers and identifying the traits of the successful aircraft broker.

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II. AIRCRAFT TRANSACTION BASICS

A. Federal Aviation Regulations Overview: Commercial vs. Non-Commercial

Federal Aviation Regulations (FARs) govern the operation and use of business aircraft. If an aircraft operation is for "compensation or hire" then it is a commercial operation and must be operated by a Part 135 certificate holder and under the more restrictive operational regulations of Part 135.[1] Non-commercial operations are governed by the less restrictive Part 91 rules.[2] Generally speaking, Part 135 has more stringent requirements than Part 91 for weather reporting, aircraft certification and maintenance, pilot duty time, and take-off and landing distance restrictions. Further, Part 135 operations require the collection of the Federal Excise Tax (FET) which is a tax of approximately 7.5% along with segment fees. Non-commercial operations under Part 91 do not require collection of the FET but are subject to payment of a Federal fuel tax.

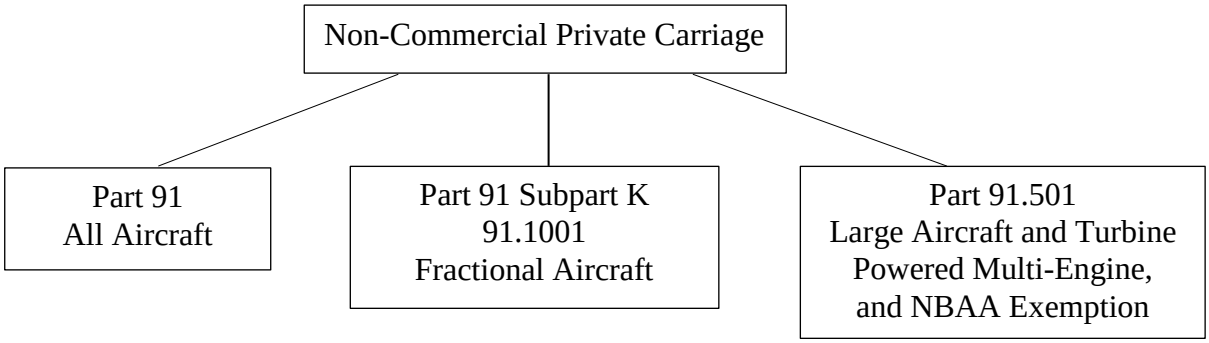
An entity which operates an aircraft commercially without a certificate is subject to civil penalties,[3] and pilots flying such illegal operations are subject to certificate suspension or revocation.[4]

The following chart graphically presents a simplified flow chart describing commercial and non-commercial operations:

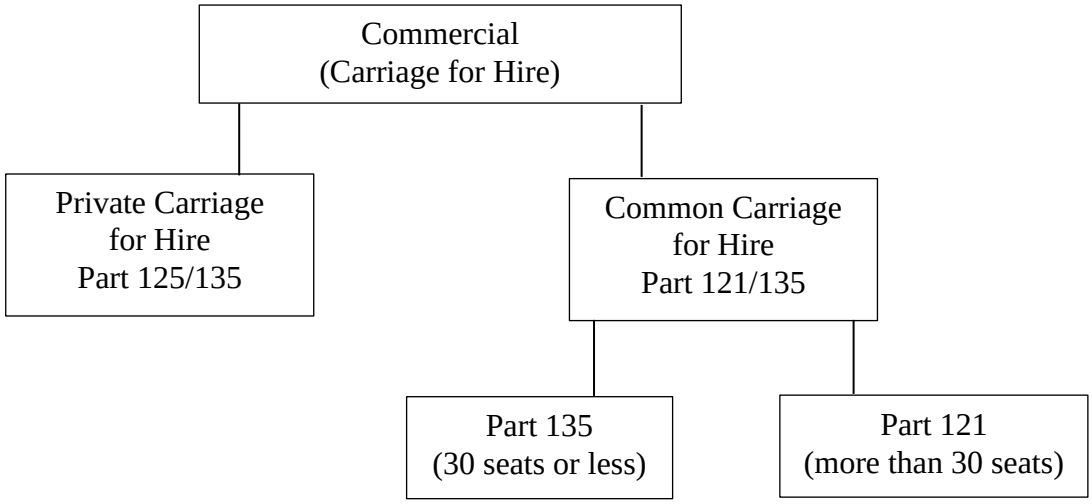
[1] 14 C.F.R. § 119; 14 C.F.R. § 135.
[2] 14 C.F.R. § 91.
[3] 49 U.S.C. § 46301.
[4] *See* 14 C.F.R. § 135.343; 14 C.F.R. 91.13(a); 14 C.F.R. 91.706.

Business Aircraft FARs

NO CERTIFICATE REQUIRED:



CERTIFICATE REQUIRED:



B. General Rule

The FAA does not generally allow compensation of any kind for Part 91 flights. There are limited exceptions:

Dry Lease (Lease of aircraft without crew)

91.501 (Exceptions for large aircraft)

91.1001 (Fractional interests)

61.113 (Private pilot reimbursement)

91.321 (Carriage of candidates for federal elections)

1. Flight Department Company

The "Flight Department Company" issue arose as various companies attempted to insulate the company's assets by creating a separate entity that would own and operate the aircraft. The FAA has consistently viewed such "Flight Department Companies" as commercial operation. Attached to this paper is a memorandum containing three FAA decisions (1981, 1982, 1989) and a FAA Chief Counsel opinion letter (2007) which reflect the FAA's view that a company that exists solely for the purpose of "owning and operating" an aircraft is a commercial operator which must possess a commercial certificate.[5] The FAA applies a "primary business" or "major enterprise" test and asks "whether the carriage by air is merely incidental to the person's other business or is, in itself, a major enterprise for profit."[6] There are some exceptions under Subpart F to Part 91 (Part 91.501, formerly known as 91.181) such as intra-corporate family operations, co-ownership, timesharing, demonstration flights and interchange agreements.

[5] See Appendix 1.
[6] 14 C.F.R. § 1.1.

2. FAR. 91.501. Exceptions to General Rule that no charges may be made for Part 91 Operations

There are limited exceptions to the general rule that an aircraft owner/operator cannot be compensated for Part 91 flights.

FAR. 91.501 applies to U.S. registered large (greater than 12,500 lbs.) airplanes (not small civil airplanes or helicopters), turbo-jet powered multi-engine civil aircraft and fractional ownership aircraft.[7] Members of the NBAA may seek an exemption for aircraft not meeting the basic qualifications.[8]

The main 91.501 exceptions are:

Intra-corporate Family Operations

Time Sharing

Interchange

Joint Ownership

a. Intra-corporate Family Operations

The Intra-corporate Family operations are an exception to the general rule that commercial operations are not allowed under Part 91. Under 91.501(b)(5),

> "carriage of officials, employees, guests and property of a company on an airplane operated by that company, or the parent or a subsidiary of the company or a subsidiary of the parent, when the carriage is within the scope of, and incidental to, the business of the company (other than transportation by air) and no charge, assessment or fee is made for the carriage in excess of the cost of owning, operating, and maintaining the airplane, except that no charge of any kind may be made for the carriage of a guest of a company when the carriage is not within the scope of, and incidental to, the business of that company."

[7] 14 C.F.R. § 91.501(a). Fractional aircraft ownership and Fractional ownership programs are also governed by Subpart K, 14 C.F.R. § 1001.

[8] NBAA Small Aircraft Exemption 7897F, attached as Appendix 2.

This section does not apply when the sole purpose of the company is the ownership of the aircraft. The company owning the aircraft must have a primary business purpose other than the ownership of the aircraft for this exception to apply.

b. Time Sharing

An aircraft owner may supply both the aircraft and crew to a third party (company officials, employees or guests of the company) pursuant to a time sharing agreement.[9] The amount of compensation allowed can generally be no more than two times the actual cost of fuel for the specific flight plus incidental expenses related to that flight including:[10]

1) travel expenses of the crew, including food, lodging, and ground transportation;
2) hangar and tie-down costs away from the aircraft's base of operations;
3) insurance obtained for the specific flight;
4) landing fees, airport taxes, and similar assessments;
5) customs, foreign permit, and similar fees directly related to the flight;
6) in flight food and beverages;
7) passenger ground transportation; and
8) flight planning and weather contract services.

While time sharing is a non-commercial operation in the FAA's opinion, the IRS views it as a commercial operation and requires the time sharor (aircraft owner) collect and remit the 7.5% FET. Also, a time sharing agreement is a Lease and the Truth-in-Leasing requirements of 14 C.F.R. § 91.23 must be met.[11]

[9] 14 C.F.R. § 91.501(b)(6); 14 C.F.R. § 91.501(c)(1).
[10] 14 C.F.R. § 91.501(d)(1).
[11] 14 C.F.R. § 91.23; form Aircraft Time Sharing Agreement, attached as Appendix 3.

c. Interchange Agreement

Aircraft owners may exchange equal time on each other's aircraft and then collect the difference of the cost of "owning, operating and maintaining" the two aircraft.[12] Again, this is in the IRS' view a commercial operation and FET applies. The parties must also comply with Truth-in-Leasing requirements.

Because there can be no "true-up" for unequal use of each other's aircraft the Interchange option is impractical for most aircraft owners.[13]

d. Joint Ownership

If you have co-ownership of an aircraft (each owner owns an undivided interest and is a registered owner) the parties can agree to a Joint Ownership Agreement whereby one of the registered joint owners employs and provides the flight crew and the joint owners pay a share of the charge specified in the Agreement.[14] If the co-owners use a flight crew not employed by a co-owner then they could join in a "Co-Ownership Agreement" and charge up to the cost of owning, operating and maintaining the aircraft. Note that other 91.501 exceptions cannot be combined with Joint Ownership. The FAA views a Joint Ownership Agreement as a lease and Truth-in-Leasing provisions apply.

C. U. S. Civil Aviation Registry

Located in Oklahoma City, the U.S. Civil Aviation Registry is where "interests in aircraft"[15] are filed. The aviation practitioner's interface with the Civil Registry will normally be through an aircraft title or escrow company located in Oklahoma City or through one of several

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[12] 14 C.F.R. § 91.501(b)(6); 14 C.F.R. § 91.501(c)(2).
[13] In fact, fractional ownership "Interchange Agreements" are really "Dry Lease Exchanges" because a true Interchange Agreement cannot contain a "true-up" provision for unequal time.
[14] 14 C.F.R. § 91.501(b)(6); 14 C.F.R. § 91.501(c)(3).
[15] *See* U.S.C. 49 § 44103; 14 C.F.R. § 47; 14 C.F.R. § 49 (aircraft registrations, bills of sale, security interests, liens, etc.).

Oklahoma law firms specializing in aviation transactions who often act as FAA special counsel for lenders and aircraft manufacturers.[16]

1. U.S. Citizenship Requirement

An aircraft is eligible for U.S. registration if it is not registered in a foreign country and it is owned by:

a. A Citizen of the United States;[17]

b. A resident alien;[18] or

c. A non-citizen U.S. corporation and the aircraft is based and primarily used in the United States (BAPU).[19]

The applicant that falls into one of the three classes above can register an aircraft by any of the following methods:

a. As an individual citizen of the United States;

b. As an individual resident alien;

c. As a corporation which qualifies as a citizen of the United States;

d. As a corporation which is a non-citizen United States corporation and the aircraft will be based and primarily used in the United States;

e. As a limited liability company which qualifies as a citizen of the United States;

f. As an unincorporated association which qualifies as a citizen of the United States;

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[16] Note that FAA special counsel are partners at private law firms and should not be confused with the FAA lawyers of the office of Aeronautical Center Counsel's (ACC) office.
[17] 49 USC § 40102(a)(15); 14 C.F.R. § 47.3(a)(1).
[18] 49 USC § 44102(a)(1)(B); 14 C.F.R. § 47.3(a)(2) (individual citizen of a foreign country lawfully admitted for permanent residence in the United States).
[19] 14 C.F.R. § 47.3(a)(3).

g. As a partnership which qualifies as a citizen of the United States;

h. As a co-owner of an aircraft, if each co-owner applicant qualifies in one of the above categories (a – g); and

i. As an owner trustee, who qualifies as a citizen of the United States.

2. Citizenship Tests

a. Partnership

All the partners, both general and limited, must be individual U.S. citizens.[20] Even if the general partner is a corporation which otherwise qualifies as a U.S. citizen, the partnership would not pass the U.S. Citizenship test because one of its partners is an entity and not an individual U.S. Citizen.

b. Corporations or LLC

Corporations, unincorporated associations and LLCs are governed by the same three part test:

i. Formation

The entity must be organized and in existence[21] under the laws of the United States or individual state, the District of Columbia or a U.S. territory or possession.[22]

ii. Management

The President, 2/3 of the managing officers and 2/3 of the directors (or for a LLC, 2/3 of the managers) must be U.S. citizens.[23]

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[20] 49 USC § 40102(a)(15); 14 C.F.R. § 47.7(d).

[21] 49 USC § 40102(a)(15); Also note that an entity that has forfeited its charter or corporate existent for failure to comply with state requirements (*i.e.*, tax) is no longer a U.S. Citizen.

[22] *Id.* However, the FAA and the Aeronautical Center Counsel's office has taken the position that in the case of an LLC the LLC must submit a Statement in Support of Registration, it cannot register under the "based and primarily used" provisions of 14 C.F.R. § 47.9, and that a resident alien cannot be a manager of a LLC.

[23] *Id.*

iii. Control

At least 75% of the voting interest must be owned or controlled by U.S. citizens.[24]

D. Owner Trusts (Non-citizen Trusts)

The most common solution when an applicant cannot satisfy the U.S. Citizenship test is the use of an Owner Trust.[25] With the Owner Trust, the individual or entity that cannot satisfy the U.S. Citizenship requirements can transfer title to a trustee who qualifies as a U.S. citizen. The aircraft is then registered in the name of the Owner Trustee (applicant) who holds legal title to the aircraft for the benefit of the trustor/grantor/beneficiary.[26]

The applicant would file the following documents with the Application for Registration:

1) Trust Agreement

2) Operating Agreement (if applicable)

3) Trustee Affidavit[27]

E. International Registry of Mobile Assets

1. What is it?

The International Registry (IR) is an electronic registry for electronic registration and protection of "international interests"[28] in aircraft on a "First to File" basis.[29] The United States adopted the Cape Town Treaty on August 9, 2004, ratified the Convention on October 28, 2004, and it became effective March 1, 2006.[30]

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[24] *Id.*
[25] 14 C.F.R. § 47.7; *see also* C.F.R. § 47.8. Voting Trusts, which have much of the same requirements of the Owner Trust, can also be used but experience shows they are not as prevalent.
[26] 14 C.F.R. § 47.7(c).
[27] 14 C.F.R. § 47.7(c)(2).
[28] The Convention on International Interests in Mobile Equipment and Protocol on Matters Specific to Aircraft Equipment, November 16, 2001.
[29] *Id.* International interests include security interests, leasehold interests, conditional sale agreements and ownership interests.
[30] Cape Town Implementation Act of 2004, August 9, 2004.

The IR creates "an international legal framework for creating, registering, enforcing and determining the priority of security and other interests in aircraft equipment."[31] Registration on the IR is required by almost all lenders and is a recommended practice even when no financing is involved.

2. What equipment qualifies for IR recording?

The aircraft and engines that qualify for International Registry recording are:

a. Aircraft – certificated to carry 8 people (including crew) or cargo in excess of 6050 pounds.

b. Helicopters – certificated to carry at least 5 people (including crew) or cargo in excess of 990 pounds

c. Engines – jet propulsion engines with at least 1750 pounds of thrust or turbine/piston powered engines with at least 550 rated take-off horsepower.

3. How do I register?

The International Registry is sometimes misunderstood to apply only to aircraft that will travel internationally. This is an incorrect understanding in that any aircraft transaction between two United States parties which is recorded with the U.S. Civil Registry should also be recorded with the International Registry if the equipment and the interest qualify. The basic steps include the Seller, Buyer or Lender registering as a Transacting User Entity (TUE) and then appointing an individual at an Oklahoma City title company or law firm as a Professional User Entity (PUE) who will register the international interest at the IR on behalf of the TUE. The TUE completes a Confirmation of Entitlement to Act appointing the PUE and identifying a "back-up contact," an individual within the TUE, who will confirm electronically that it is registering as a TUE and

[31] https://www.internationalregistry.aero/ir-web/faq.

appoints the PUE as its agent for IR purposes. The filing of international interests with the IR is accomplished by first filing the interest with the U.S. Civil Registry and then completing a FAA AC Form 8050-135, FAA Entry Point Filing Form International Registry. The FAA will review the Form 135 and give it a unique authorization code which will be used by the PUE to record the interest with the International Registry. The PUE will then obtain a post-closing Priority Search Certificate for the airframe and each engine which will confirm the recording of the international interest.

III. ASSISTING THE ACQUISITION PROCESS

Armed with this information, the aviation practitioner will want to advise and guide his client throughout the acquisition process from the preliminary preparations through the closing and then post-closing operations.

The basic steps of the acquisition process include:

a. Preparation;

b. Offer to Purchase and Purchase Agreement;

c. Pre-Purchase Inspection;

d. Closing; and

e. Post-Closing Operations.

A. Preparation

At this step of the process the aviation practitioner will want to identify the client's needs and the key advisors in the project.

1. Client Needs

For the first time buyer, there are several options for aircraft utilization based upon the client's type of use (personal or business) and level of use measured in annual hours. The major types of aircraft utilization, measured in increasing hours of annual use, are:

Lowest: Charter

Jet Card

Fractional Ownership

Joint or Co-Ownership

Lease

Highest: Whole Aircraft Ownership

Generally speaking a buyer with a projected annual use of 50-75 hours would be better served with a charter, Jet Card or fractional utilization than with the lease or purchase of a whole aircraft. Additionally, a client who plans to use the aircraft for primarily personal travel needs to know there will be tax consequences because of personal use.[32]

2. Key Advisors

The client may have already engaged an aircraft broker. In addition, you want to identify individuals associated with the client who can provide accounting, tax and financing information as well as the title company and insurance broker who you will work with throughout the process.[33]

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[32] Tax consequences include unfavorable limits to expense deductions and depreciation and a potential favorable reduction in the amount of *ad valorem* or property taxes.

[33] Appendix 4 is an intake checklist that will help identify these key advisors as well as other key issues such as financing and like kind exchange.

B. Offer to Purchase and Purchase Agreement

1. Offer to Purchase (or Letter of Intent)

Generally, an Offer to Purchase should be a non-binding agreement that sets the major deal points including:

Purchase Price and Deposit

Timing (Purchase Agreement deadline, begin inspection deadline or closing deadline)

Scope of Inspections (if known)

Delivery condition of clear title

Any other business terms Buyer considers deal breakers (choice of Inspection Facility, Delivery Location, financing contingency)

The Offer to Purchase should be subject to the execution of a mutually acceptable Purchase Agreement.

C. Purchase Agreement

This will be the binding legal agreement establishing the Buyer and Seller's obligations throughout inspection, delivery and closing. In addition to the terms outlined in the Offer to Purchase it should include:

a. Detailed Inspection Scope and Inspection Facility

b. Repositioning Costs (to Inspection Facility and to Delivery Location)

d. Delivery conditions (airworthy, no damage history, no material corrosion).

e. Seller's obligations to correct discrepancies (define airworthiness discrepancies).

f. Full or limited right of Buyer to reject aircraft after inspection.

g. Warranties or Service Plans transferrable

h. Identification of title company/escrow agent

i. Pre-closing conditions including each party's documentation requirements

j. Deposit – when does it become non-refundable

k. Tax indemnity

l. U.S. Patriot Act compliance

m. "As-is, where is" provision

n. Default and Remedies

o. Governing Law

p. International Registry

D. Pre-Purchase Evaluations

The selection of the Inspection Facility and the Scope of Inspection should be detailed as early as the Offer to Purchase and should be finalized and detailed in the Purchase Agreement. There are several considerations facing the aviation practitioner in guiding his client through the selection of the Inspection Facility and Scope of the Inspection.

1. Inspection Facility.

Usually a manufacturer service center will provide a thorough and neutral inspection. Buyers should avoid facilities that have provided routine maintenance to the Seller. Experience has shown that Buyer and Seller should both avoid facilities that have a close relationship with the other party's aircraft broker or management company. Depending on your state tax strategy an Inspection Facility located at the delivery location is a plus.

2. Scope of Inspection.

There is an unavoidable tension between the Buyer and Seller on the Scope of Inspection. Buyer normally pays for the inspection and wants to maximize the Scope of Inspection. Seller normally pays to rectify discrepancies so it naturally wants to limit the scope as much as possible.

Attention should be given to upcoming hour or calendar maintenance. Seller should ensure maintenance coming due on or before the anticipated closing date (or shortly thereafter) will be completed so that Seller's Purchase Agreement promise to deliver the aircraft "current on all calendar or time-based maintenance and inspections" is true. Buyer should look beyond the closing date to see if there are upcoming inspections/maintenance that could be conducted in conjunction with the pre-purchase evaluation and, if there are, seek Seller's permission to accomplish those tasks.

a. Airworthiness Discrepancies.

It is common for a Purchase Agreement to make the Seller responsible for correcting all "airworthiness discrepancies." The FAA definition of "airworthy" is the "aircraft conforms to its type design and is in a condition for safe operation."[34] A popular mechanism to determine whether a discrepancy rises to the level of "airworthiness discrepancy" if Agreement cannot be reached[35] is to let the Inspection Facility make that decision.

b. All Systems Operating Normally

Another common delivery condition is that the aircraft be delivered in conformity with its specifications and with "all systems operating normally." It is important for the Seller to ensure that the specification sheet attached to the Purchase Agreement is current as to time/cycles and

[34] 14 C.F.R. § 3.5; *see also* 14 C.F.R. § 91.7 – Civil Aircraft Airworthiness.
[35] Experience has demonstrated that having a knowledgeable aircraft broker representing your client's interests on site at the Inspection Facility is an invaluable aid to avoiding disagreements.

has an accurate list of the aircraft equipment, both in the cockpit and in the cabin. Additionally, the parties should consider whether all cabin equipment such as lights or flight phones are "systems" which should be operating normally.

E. Closing

The key to a successful closing is confirmation several days prior to closing, through a review of the Purchase Agreement or a Closing Checklist[36] based upon the Purchase Agreement, that the delivery conditions have been met and the required documentation is in place. Several closing documents (FAA Bill of Sale, Warranty Bill of Sale, Application for Registration, Delivery Receipt) must be submitted with original signatures and must be left undated when they are pre-positioned with the title company.

Assuming the correct closing documents have been pre-positioned Seller and Buyer should confirm:

1. Seller
    a. Purchaser has paid for the pre-purchase evaluation and any test/delivery flights.
    b. Full purchase price is in escrow.
    c. Purchaser has paid any sales tax due or provided evidence of or a certificate of exemption
2. Buyer
    a. All liens on aircraft are cleared or will be cleared simultaneously with closing.
    b. Seller has paid inspection facility all costs for correction of airworthiness

[36] A sample Closing Checklist is attached at Appendix 5. The Checklist you use should conform to the Purchase Agreement and be revised if there are export/import issues or financing.

discrepancies.

c. Transaction can be recorded on the International Registry.

d. Insurance (hull and liability) is in place.

F. Post-Closing Operations

Most of the details to be completed post-closing fall to the Buyer but there are a few items Seller should consider:

1. Seller

   a. Remove old registration (hard card) from the aircraft and return to FAA.

   b. Cancel insurance.

   c. Assist with transfer of warranties/maintenance programs.

2. Buyer

   a. Place dated Temporary Registration and Dry Lease (if applicable) on the aircraft.

   b. Complete transfer of warranties/maintenance programs.

   c. Obtain Letters of Authorization (RVSM, etc.)

   d. International Registry Post-Closing Priority Search Certificates.

IV. TAXES

A. Federal Taxes

It is outside the scope of this paper to present an in-depth review of the federal taxes normally associated with business aircraft. What is presented, however, is a thumbnail sketch of the major provisions identified by Internal Revenue Code section number and common name. Hopefully this will allow the aviation practitioner to more intelligently follow the Federal tax guidance provided by experts in the subject.

1. I.R.C. § 162 – Trade or Business Expenses

In general, a taxpayer[37] may deduct the expenses associated with aircraft operations if:

a. The aircraft activity is a trade or business activity[38]; and

b. The expenses are ordinary, necessary and reasonable.[39]

There is, however, a limitation to Section 162 deductions.

2. I.R.C. § 183 – "Hobby Loss" Rules

When the aircraft activity does not have a profit motive the trade or business expenses are deductible only up to the amount of income produced by the activity.[40]

3. I.R.C. § 167-168 – Depreciation

A taxpayer may take a deduction for an aircraft used in a trade or business or the production of income for "exhaustion, ordinary wear and tear and obsolescence,"[41] commonly called "depreciation."

Generally speaking the applicable depreciation recovery period using the Modified Accelerated Cost – Recovery System (MACRS) is:

a. Part 91 non-commercial operations – 5 year MACRS

b. Part 135 commercial operations – 7 year MACRS

Not surprisingly, there is a limitation on sections 167-168 depreciation using MACRS.

4. I.R.C. § 280F – Qualified Business Use

To use the MACRS depreciation method the taxpayer must use the aircraft in a Qualified Business Use (taxpayer's trade or business) for more than 50% of the use.[42]

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[37] The taxpayer may or may not be the entity owning the aircraft depending on the entity's elections.
[38] I.R.C. § 162. Generally the activity must be one which has a profit motive.
[39] *Id.*
[40] I.R.C. § 183.
[41] I.R.C. § 167.
[42] I.R.C. § 280F.

5. I.R.C. § 274 – Entertainment, Recreation and Amusement

Aircraft expense deductions used for entertainment, amusement and recreational flights of certain individuals[43] are deductible only to the amount of income imputed or reimbursed to that individual.[44]

6. I.R.C. § 469 – Passive Loss

Depreciation and operating expense deductions from a "passive" activity can only be used to offset gains from the "passive" activity.[45] Aircraft "rental" is viewed by the IRS as "*per se* passive" even if the taxpayer materially participates in the activity.[46]

7. I.R.C. § 1031 – Like Kind Exchanges

A taxpayer may defer the taxable gain (sales price less depreciated basis in the aircraft) of an aircraft if it complies with I.R.C. § 1031 provisions. There are several general qualifying rules:

1. The same taxpayer who sells the Relinquished Aircraft must purchase the Replacement Aircraft.
2. The predominate use (*i.e.*, business vs. charter) of both aircraft must be the same.
3. All 1031 exchange documents must be executed prior to the first qualifying transaction.
4. The Replacement Aircraft must have at least as much equity and value as the Relinquished Aircraft to get the full tax benefit.

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[43] I.R.C. § 274. "Specified Individuals" are generally officers, directors or persons owning more than 10% of the taxpayer.
[44] I.R.C. § 274.
[45] I.R.C. § 469. A passive activity is one in which the taxpayer does not "materially participate."
[46] *Id.*

5. If the Relinquished Aircraft is sold first, taxpayer has 45 days to identify the Replacement Aircraft and 180 days to close on the Replacement Aircraft purchase.

8. Federal Excise Tax (FET)

The United States currently funds much of its air transportation system through taxes on commercial (Part 121, 125, 135) transportation (FET) and taxes on non-commercial Part 91 transportation (FET Fuel Tax). The FET on commercial operations is 7.5% plus a $3.90 segment fee for domestic operations. The FET Fuel Tax charged on jet fuel is 21.9¢/gallon with a 17.54¢/gallon rebate paid to commercial operators quarterly.

The IRS (not the FAA) views time sharing, interchange and intra-corporate family operations (when the affiliated group is not connected by 80% or more voting stock) as commercial operations and the 7.5% FET tax and segment fee is due on the amount collected for those operations.

B. State Taxes

There are two primary types of state taxes that generally affect aircraft acquisitions and ownership — the state sales and use tax and the local *ad valorem* or personal property tax. What follows is a short description of these taxes generally and then a description of specific Texas sales and use tax provisions, as well as property tax and its interstate allocation provisions.

1. Sales and Use Tax Generally

a. General Description

As a general rule a state sales tax is a tax on the transfer of tangible personal property for compensation. A use tax is a tax on tangible personal property that is "used" or stored in the

state. Normally an aircraft owner (unless an exemption applies) must pay either the sale or use tax, but not both.[47]

There are a few states (Alaska, Montana, New Hampshire, Oregon) that do not have a state sales or use tax[48] and some (Massachusetts and Rhode Island) that do not impose the tax on aircraft.[49]

2. Fly Away Exemption

Additionally, there are several states that have some form of a "Fly-Away" exemption whereby a non-resident of the state in which the aircraft is delivered is not subject to that state's sales tax if the aircraft is removed from the state of delivery (either the first use is the removal of the aircraft from the state or it is removed within a short time period).[50] As with most exemptions the Fly-Away exemption is narrowly construed and each state's requirements must be carefully reviewed and documented to demonstrate compliance.

3. Use Tax

Even if the aircraft delivery occurs in a state with a "Fly-Away" exemption, use tax will normally be due in the state where the aircraft is hangared or domiciled. There are a few types of exemptions from sales or use (or both) taxes which may be available depending on the state. The common exemptions are:

a. Commercial Carrier – Generally available only to a certificate holder who owns, not just operates, the aircraft.

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[47] *See generally* www.nbaa.org, State Aviation Taxes (available to NBAA members only). Alaska (no state sales/use tax but local tax depending on borough); Oregon (does impose corporate excise tax).
[48] *Id.*
[49] *Id.*
[50] *Id.* Arizona, Florida, Kansas, Nebraska, Tennessee, Texas all have Fly Away exemptions with varying restrictions.

b. Occasional or Casual Sale – Often narrowly construed to include only individuals or businesses that do not hold sales tax permits and who make isolated sales of tangible personal property.

c. Resale Exemption – Dealers holding aircraft for inventory (resale) or entities holding the aircraft for lease to third parties (but tax likely due on lease payments).

d. Entity Sale – the sale of stock or membership interests may not be regarded as a sale of tangible personal property and therefore not subject to the tax.

It is important to note that a majority of states have become very aggressive in their taxation of aircraft. Every aviation practitioner should advise the client that a state sale/use tax audit is not a matter of "if" but rather a matter of "when."

4. Property Tax

Most states impose personal property tax or registration fees on aircraft and there are some states that impose both (Virginia, Alaska, Utah).[51] The tax or registration fee can be assessed based on a flat fee, aircraft weight or fair market value.[52]

C. Texas

Texas, like many other states, has aggressively pursued enforcement and collection of aircraft sales and use tax. The Comptroller's Business Activity Research Team (BART) has dedicated aircraft specialists who review FAA public filings and send audit letters to Texas aircraft owners. Any aircraft owner who is a resident of Texas or hangars its aircraft in Texas should expect such an audit letter sometime after the acquisition even if delivery of the aircraft occurred in a tax friendly location outside of Texas.

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[51] *See generally*, www. nbaa.org, State Aviation Taxes.
[52] *Id.*

The basic Texas sales and use tax rate is 6.25%, which may increase to 8.25% after local taxing jurisdictions add their maximum allowable 2%.[53]

1. Use Tax

A common Texas use tax scenario is when an aircraft owner purchases an aircraft outside of Texas and the aircraft is brought to Texas within one year of its first use. Use tax will be imposed on the aircraft if it is hangared in Texas or more than 50% of its use is within Texas.[54]

"Use" in Texas. The Comptroller will consider flight time and hangar time in Texas as well as overflight time through airspace above Texas.[55]

"Hangared" in Texas. The Comptroller will consider hangar leases in Texas, if the aircraft owner pays personal property tax on the aircraft in Texas or if the aircraft owner has represented to a lender, an insurer, the FAA or another taxing authority that the aircraft is hangared in Texas.[56]

2. Exemptions

Texas follows the general rule that any tax exemption will be strictly construed against the taxpayer. Texas, like many other states, exempts aircraft owned and operated by certificated air carriers from sale and use tax.[57] Also, Texas has a "Fly Away" exemption so long as the aircraft is sold to an owner who will register and use the aircraft in another state and the first "use" of the aircraft (other than flight training) is to fly the aircraft out of Texas.[58]

The most common exemptions to sales or use tax available to the Texas based aircraft owner are the "occasional sale"[59] and "sale for resale"[60] exemptions.

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[53] Sales and Use Tax Bulletin, Texas Comptroller of Public Accounts, February, 2008.
[54] 34 Tex. Admin. Code § 3.297 (c)(3)
[55] *Id.*
[56] *See, e.g.*, 34 Tex. Admin. Code § 3.297(c)(4).
[57] Tex. Tax Code § 151.328(a).
[58] Tex. Tax Code § 151.328(a)(4).
[59] Tex. Tax Code § 151.304; 34 Tex. Admin. Code § 3.316.

a. "Occasional Sale." Both the Buyer and Seller must meet certain requirements to qualify for this exemption. The Seller cannot hold a sales tax permit, cannot be in the business of "selling, leasing or renting" tangible personal property, software or taxable services, and cannot have made more than two sales in the rolling 12 month period immediately prior to the sale.[61] The Buyer cannot hold a sales tax permit and the occasional sale exemption does not apply to leases.[62]

b. The "sale for resale" exemption has received increased scrutiny by the Texas Comptroller in recent years. Aircraft purchased for the purpose of resale (inventory) are exempt from sales and use tax. If the aircraft is then leased, sales tax must be paid on the lease payments.[63]

One common aircraft ownership structure experienced is for a Texas aircraft owner to create a single purpose entity for liability purposes and then, to avoid the "Flight Department Company"/FAA issue, lease the aircraft to a related party as the end user. The Comptroller has taken the position that the lease to a related party does not qualify as a lease for sale for resale purposes, unless the aircraft owner charges a fair market rental rate and does not reserve the option to use the aircraft itself. Further, the Comptroller and its auditors have developed a policy or enforcement position that, depending on the value of the aircraft, leases between related parties require a set monthly rental rate be at least 1.15% or 1.49% of the fair market value of the aircraft.[64]

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[60] Tex. Tax Code § 151.302.
[61] 34 Tex. Admin. Code § 3.316.
[62] *Id.*
[63] Tex. Tax Code § 151.302; Tex. Tax Code § 151.006.
[64] These interpretations and policies are not from changes to the Tax Code or Administrative Code but are the result of decisions of the Texas State Office of Administrative Hearings (SOAH).

3. Local Property Tax in Texas

Property taxes are assessed by the local taxing jurisdictions on all income producing personal property located within that jurisdiction on January 1 of each year.[65] Most aircraft owners can reduce the taxable value of their aircraft by showing they are entitled to an interstate allocation (business or commercial) so the taxpayer is not taxed for use outside of Texas.[66] Depending on whether the business aircraft formula or the commercial aircraft formula is used will have a drastic effect on the aircraft personal property tax. Very often applying the commercial allocation formula will result in a net tax that is only 3-5% of the tax due from application of the business aircraft allocation.[67]

V. BUSINESS DEVELOPMENT

A. Resources

Once an aviation practitioner becomes familiar with the basic phases of the aircraft transaction she may then reach out to potential team members who can add their expertise. Almost every firm will have corporate and tax attorneys who can guide the new aviation practitioner through the local, state and federal tax issues. A corporate attorney can help solve a partnership U.S. citizenship problem by advising the merger of the partnership into a limited liability company. A federal tax advisor should be able to assist with evaluating the possibility of like-kind exchanges or depreciation. State tax attorneys within the firm can likely evaluate state sales and use tax exemption strategies or help with local property tax issues.

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[65] Tex. Tax Code § 11.14(a); It has been the author's experience that most appraisal districts take the position that an aircraft held by an entity and not an individual is presumed to be income producing.
[66] *See*, Tex. Tax Code § 21.055 (business aircraft) and Tex. Tax Code § 21.05 (commercial aircraft).
[67] *See* Appendix 6 for a comparison of the two formulas and taxes due.

Also useful are various business aircraft trade groups and associations. The National Air Transportation Association (NATA),[68] National Business Aircraft Association (NBAA)[69] and National Aircraft Finance Association (NAFA)[70] are organizations that regularly post updates on issues facing business aircraft owners and changes to government regulations. These organizations also have instructional pamphlets and handbooks authored by highly experienced aviation practitioners which can be quite useful to the new aviation practitioner. Finally, the trade organizations sponsor conferences throughout the year and all over the United States where these same experienced practitioners explain the law, provide updates and answer questions.

B. Developing a Client Base

There are probably already aircraft owners who are clients of the firm. Once an aviation practitioner develops an understanding of the aviation transaction basics it's a relatively simple matter to publicize your expertise inside the firm. Existing firm clients may also have referrals to other aircraft owners.

Another business development tool is to attend various business aircraft conferences where you can meet aviation professionals you are likely to encounter in various transactions. Many times fellow attendees will seek you out when they have questions related to the jurisdiction in which you practice or if they need to refer a client because of a conflict.

C. Aircraft Brokers

Aircraft brokers are a great networking source. The good aircraft broker is technically proficient and can guide you and your client through preparation, pre-buy evaluations and closings. A good aircraft broker will also have a good sense of the current market for new and

[68] www.nata.aero
[69] www.nbaa.org
[70] www.nafa.aero

used aircraft. Some brokers specialize in specific manufacturers and models while many others deal only in turbo-props or turbo-fan powered aircraft.

Brokers are normally paid on a fixed commission or a percentage of the sales price. It is important to note that almost all brokers do not get paid unless the deal closes. The new aviation practitioner should avoid situations where one or both brokers are pushing a deal through to closing when the deal is really not ready to close. Sometimes this occurs while you are waiting for a final sign off on all airworthiness discrepancies. Although allowing post-closing rectification of discrepancies can be accomplished, it should be well documented with sufficient funds held back from closing to ensure the seller can cover the costs of repairing the discrepancies, and not the result of a rush to get the deal done.

VI. CONCLUSION

Hopefully this paper provided basic instruction on the key issues and mechanics of aircraft transactions as well as checklists and resources to guide those getting started in this field. You will find that you build on your knowledge level at every step of the transaction and with each new transaction. Hopefully you will have many repeat customers whom you helped with the purchase of the first aircraft who will come back so they can upgrade to a newer, larger and faster business jet.

APPDENDIX

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Appendix Item 1

Memorandum – Regulatory Concerns Regarding Ownership of Aircraft

JACKSON WALKER L.L.P.
ATTORNEYS & COUNSELORS

MEMORANDUM

TO:

FROM: James D. Struble, Esq.

DATE:

RE: Regulatory Concerns Regarding Ownership of Aircraft

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1. Summary

The Federal Aviation Administration (FAA) considers a single purpose entity (*i.e.*, LLC, corporation or partnership) that owns and operates an aircraft without having another business purpose as a commercial operator.

2. Regulatory Background

Federal Aviation Regulations (FARs) govern the operation and use of business aircraft. If an aircraft operation is for "compensation or hire" then it is a commercial operation and must be operated by a Part 135 certificate holder and under the more restrictive operational regulations of Part 135. Non-commercial operations are governed by the less restrictive Part 91 rules. Generally speaking, Part 135 has more stringent requirements than Part 91 for weather reporting, aircraft certification and maintenance, pilot duty time, and take-off and landing distance restrictions. Further, Part 135 operations require the collection of the Federal Excise Tax (FET) which is a tax of approximately 7.5% along with segment fees. Non-commercial operations under Part 91 do not require collection of the FET but are subject to payment of a fuel tax.

An entity which operates an aircraft commercially without a certificate is subject to civil penalties of up to $25,000 per violation. (49 U.S.C. § 46301)

3. Flight Department Company

The "Flight Department Company" issue arose as various companies attempted to insulate the company's assets by creating a separate entity that would own and operate the aircraft. The FAA has consistently viewed such "Flight Department Companies" as commercial operation and attached to this memorandum are three FAA decisions (1981, 1982, 1989) (Exhibits 1, 2, 3) and an opinion letter (Exhibit 4) which reflect the FAA's view that a company that exists solely for the purpose of "owning and operating" an aircraft is a commercial operator which must possess a commercial certificate. The FAA applies a "primary business" or "major

enterprise" test and asks "whether the carriage by air is merely incidental to the person's other business or is, in itself, a major enterprise for profit." 14 C.F.R. § 1.1. There are some exceptions under Subpart F to Part 91 (Part 91.501, formerly known as 91.181) such as intra-corporate family operations, co-ownership, timesharing, demonstration flights and interchange agreements.

4. **91.501** "Within the scope of, and incidental to, the business use of the company"

The intra-corporate family operations are an exception to the general rule that commercial operations are not allowed under Part 91. Under 91.501(b)(5) "carriage of officials, employees, guests and property of a company on an airplane operated by that company, or the parent or a subsidiary of the company or a subsidiary of the parent, when the carriage is within the scope of, and incidental to, the business of the company (other than transportation by air) and no charge, assessment or fee is made for the carriage in excess of the cost of owning, operating, and maintaining the airplane, except that no charge of any kind may be made for the carriage of a guest of a company when the carriage is not within the scope of, and incidental to, the business of that company." This section does not apply when the sole purpose of the company is the ownership of the aircraft. The company owning the aircraft must have a primary business purpose other than the ownership of the aircraft for this exception to apply.

5. **Dry Lease**

An entity whose sole purpose is the ownership of an aircraft is not prohibited by the FARs from leasing that Aircraft without a crewmember to related companies or third parties. The owner as lessor is simply providing the Aircraft to the lessee and the lessee is in "operational control" of the Aircraft and provides its own flight crew. Dry leasing requires a truth-in-leasing statement (Part 91.23) but is not a commercial operation from the FAA perspective and is not subject to the FET. So long as the pilots do not have a financial or employment relationship with the lessor, the dry lease will not be viewed as a commercial operation. See attached Federal Aviation Decision (Exhibit 4).

6. **Alternatives**

A. Individual Ownership with increased liability insurance.

B. Place Aircraft in entity with another primary business purpose and make no charges unless Aircraft use is within the scope of and incidental to the business use of the entity, its subsidiary or its parent.

C. Dry Lease from entity to its members and have member obtain pilot services from an independent third party or provide his own pilot services.

JDS/dv

Attachments

Exhibit 1
to
Regulatory Concerns Regarding Ownership of Aircraft

Flight Department Company

FEDERAL AVIATION DECISIONS

Interpretation 1981-6

FAD Digest of Interpretations:

FAR 135.1

A company that exists solely for the purpose of owning or leasing and operating a 7-passenger Cheyenne turboprop for its 3 founders, for which it will receive compensation, must hold a commercial operator certificate under Part 135, because transportation is the primary business of the company, rather than being a matter which is merely incidental to its primary business.

FAR 91 Subpart D

Although Subpart D of Part 91 applies only to large and turbojet aircraft, the owner of a small turboprop aircraft may petition for an exemption permitting it to conduct operations under Subpart D.

Source of Interpretation: Letter to Rebecca H. Baritot from Edward P. Faberman, Assistant Chief Counsel, dated January 19, 1981.

The Draft of the proposed agreement relating to the sharing aircraft usage enclosed with your letter dated November 7, 1980, has been reviewed by this office.

According to the proposed agreement, three parties will form a company designed to purchase or lease an aircraft to be used by those parties. The company will be responsible for obtaining insurance and hanger space, maintaining the aircraft, hiring pilots, scheduling, and assuring compliance with Federal Aviation Regulations (FAR).

The terms of the proposed agreement indicate that the company will exist solely for the purpose of owning or leasing, and operating an aircraft for the use of the three parties. For this it will receive compensation. Section 91.181(a) of the FAR states, in part, that the "operating rules in this subpart do not apply to those airplanes when they are required to be operated under Parts 121, 123, 129, 135, and 137 of this chapter." The preamble to Section 91.181 contains an explanation that if the primary business of persons or goods for a fee or charge of any kind would require the corporation to hold a commercial operator certificate under Part 121 or 135 of the FAR, as appropriate.

In the case of the 7-passenger Cheyenne turboprop named in your proposed agreement, a Part 135 certificate is required. Certification is necessary because transportation is the primary business of the company rather than being a matter which is only incidental to the primary business of the company.

Certification would be accomplished by the Federal Aviation Administration Region in which the operation is located. We will be glad to give you the name of the Regional Counsel for that region upon receipt of that information.

An additional issue is the fact that Section 91.181 of the FAR is applicable only to large and turbojet aircraft, while a Cheyenne is a small turboprop aircraft. If this were the only issue, you could petition for an exemption to conduct operations under the operating rules of Subpart D of Part 91.

Exhibit 2
to
Regulatory Concerns Regarding Ownership of Aircraft

Flight Department Company

FEDERAL AVIATION DECISIONS

Interpretation 1982-12

FAD Digest of Interpretations:

FAR 135.1

A corporation whose sole purpose is to provide air transportation to its 10 owner corporations, providing both the plane and the pilot, is required to hold a Part 135 Certificate.

FAR 91 Subpart D; FAR 135.1

If all owners of a corporation whose sole purpose is to provide air transportation to the owners are listed as owners of the particular airplanes involved and are members of the Business Aircraft Owners Association, and thus entitled to an exemption permitting small aircraft to operate under FAR § 91.181, the corporation may conduct its operation under Part 91 rather than Part 135.

Source of Interpretation: Letter to H.S. Demmerly from Dwight L. Larison, dated November 1, 1982.

This will refer to your memorandum of September 14, 1982, regarding the proposed operation of an aircraft for airplanes by Linn Photo Company of Cedar Rapids, Iowa. The inquiry apparently was made by Mr. Robert Priborsky of that company.

In reviewing the materials, which you forwarded, it would appear that this would violate Part 135, since the corporation to be formed would be formed for the sole purpose of providing air transportation. That corporation would be providing both pilot and plane to the 10 owner corporations and that particular corporation providing same would have to meet the requirements of Part 135.

One possibility for this operation in a slightly different form would be to proceed under Section 91.181. In that instance, however, each of the owning corporations would have to be listed as owner of the particular airplanes involved and they would have to be members of the Business Aircraft Owners Association in order to take advantage of their exemption permitting small aircraft to operate under this section.

This is the only way we can conceive at this time that they could accomplish much the same purpose and still be within the Section 91 operations and avoid the necessity of obtaining an ATCO certificate under Section 135.

Exhibit 3
to
Regulatory Concerns Regarding Ownership of Aircraft

Dry Lease

FEDERAL AVIATION DECISIONS

Interpretation 1989-20

FAD Digest of Interpretations:

FAR 135.1
The rental of an aircraft without a pilot is a "dry lease" and is not subject to Part 135 of the FAR.

Source of Interpretation: Letter to Mike Green from Kenneth E. Geier, Assistant Chief Counsel, signed by Joseph T. Brennan, Deputy Assistant Chief Counsel, dated July 29, 1989.

Your letter of July 5, 1989, to the Wichita Flight Standards District Office has been referred to this office for reply.

The situation you presented involved Company A, who owns a Cessna Conquest I which it uses for company transportation. Company A utilizes a pilot who is hired on a contract basis. Company B, from time to time, rents the aircraft from Company A for its use. Company B hires the same pilot on a contract basis. The pilot has no financial interest in the aircraft, and each company pays the pilot separately for his services. Your question is whether Company A's lease of the aircraft to Company B would be considered an operation subject to the provisions of Part 135 of the Federal Aviation Regulations.

For the sake of this opinion, it is assumed that the pilot used is an independent contractor and has no financial or employment relationship with either company other than when he/she is hired to operate the aircraft. It is further assumed that, under the rental agreement/lease agreement, Company B is free to use any qualified pilot to operate the aircraft while it is in its custody and is not required to use the same pilot as Company A.

Assuming the situation to be as set forth above, it is our opinion the rental agreement/lease agreement between the companies would be considered to be a "dry lease", and the operations would not be subject to Part 135 of the Federal Aviation Regulations.
If there are any questions, please advise us.

Flight Department Company

FEDERAL AVIATION DECISIONS

Interpretation 1989-22

FAD Digest of Interpretations:

FAR 91.181(b)
"Flight department companies" organized solely for the purpose of owning and operating aircraft do not fall within the coverage of FAR § 91.181 since the regulation requires that transportation by air be "incidental" to the company's business.

FAR 91.181(b)
The "major enterprise" or "primary business" test set forth in the definition of commercial operator in FAR § 1.1 has not been abandoned with respect to those operations listed in § 91.181(b).

Source of Interpretation: Letter to John Craig Weller from Donald P. Byrne, Acting Assistant Chief Counsel, dated August 8, 1989.

This is in response to question one of your letter of April 10, 1989, wherein you requested a legal Interpretation of Subpart D of Part 91 of the Federal Aviation Regulations (FAR) and also responds to your followup letter of July 17, 1989.

We regret the delay in responding to your inquiry but the branch responsible for that interpretation has a very heavy volume of high priority matters, including safety rulemaking, Congressional inquiries, and requests under the Freedom of Information Act. Your inquiry came at a particularly busy time as the attorney responsible for the interpretation was in the process of responding to the remand of the Aman decision issued by the Seventh Circuit Court of Appeals. The agency's response was issued on May 26, 1989. Additionally, because of the Court's opinion in Aman, that attorney has had to respond to over 30 Congressional requests for information concerning the status of the Age 60 rule. The work on the response to the Courts remand taken together with the work required to answer all of the Congressional and similar inquires consumed almost all of the responsible attorney's time from the date of your first request to the date of your followup. Moreover, we have recently learned that the petitioners have filed a notice of appeal in that case.

In your letter of April 10, 1989, you state that many corporations have decided to place their flight departments into separate companies. You refer to these as "flight department companies" and indicate that their function is limited solely to air transportation operations. You argue that a "flight department company" which operates within the parameters of Section 91.181 cannot be construed to be a commercial operator. For the reasons below, we disagree.

Subpart D, Sections 91.181 through Sections 91.215 of the FAR prescribes operating rules, in addition to those prescribed in other Subparts of Part 91, governing the operations of large and turbojet powered multiengine airplanes. Subpart D specifically authorizes an operator to receive

a very specific quantum of compensation for operations that would otherwise require some type of operating certificate. To operate pursuant to Subpart D of Part 91, the operation must come within one of the enumerated qualifications set forth in Section 91.181 (b) (1) through (b) (9).

Operations which may be conducted in accordance with paragraphs (b) (1) through (b) (9) include, when common carriage is not involved, the carriage of company officials, employees, and guests of the company on an airplane operated by that company "when the carriage is within the scope of, and incidental to, the business of the company (other than transportation by air)."

There is no better settled rule of statutory construction than that which has become known as the plain meaning rule. When the promulgators' intention is so apparent from the face of the regulation that there can be no question as to its meaning, there is no reason for construction. Language that is clear, as is the case with Section 91.181, must be held to what it plainly expresses. Specifically, Section 91.181 (b) (5) allows the carriage of company officials, employees, and guests on a company aircraft provided the carriage is - "*incidental*" - to the company's business. Clearly, when the redactors adopted the concept of "incidental," they contemplated that the company's aviation activities would be secondary to the overall business of the company.

The business structure you describe, viewed as a whole, does not fit the literal language of FAR 91.181 (b) (5), which does not provide for "flight department companies." Additionally, it is clear that these "flight department companies" are organized solely for the purpose of owning and operating aircraft. If so, they do not fall within the coverage of Section 91.181 since that regulation requires that transportation by air be "incidental" to the company's business. In order for these "flight department companies" to conduct the operations you describe, they must obtain an appropriate operating certificate.

The "major enterprise" or "primary business" test set out in the definition of commercial operator in Section 1.1 has not been abandoned with respect to those operations listed in Section 91.181 (b). Notice 71-32 (published in the Federal Register on October 7, 1971 (36 F.R. 19507)), proposed new Subpart D and made this clear in discussing the carriage of goods as incident to a primary business. The notice states:

> The decision to apply Subpart D to the carriage of goods incident to a primary business in not intended to change the applicability of Part 121 to those operations which involve primarily the transportation of cargo by aircraft from one point to another solely for the purpose of sale. Such transportation is considered to be a major enterprise in itself, and may not be conducted with a large aircraft by a person who does not hold an operating certificate issued under Part 121.

This policy was reiterated in the preamble to Amendment 91-101 as follows:

> Although this change in policy (permitting the carriage of property in furtherance of a business) permits a greater use of an airplane as an incident to a business, it does not change the FAA policy in regard to the carriage of goods or property by airplane when such carriage is the primary business of the operator of the airplane. When such carriage

> is in fact a major enterprise in itself, it may not be conducted by any person unless he holds an operating certificate under Part 121 or 135, as applicable.

The preamble also applies the primary business test to operations by a subsidiary corporation whose sole purpose is to provide transportation to the parent corporation, a subsidiary or other corporation.

In conjunction with the foregoing, none of the operations you describe to be conducted by the "flight department companies" in question one, of your letter, may be conducted under Subpart D of Part 91. As you are aware, you have the option of petitioning the FAA for rulemaking to amend Section 91.181 in accordance with FAR 11.25.

As stated above, the branch responsible for that interpretation has a very heavy volume of high priority matters and, therefore, cannot respond to both of your inquiries at this time. We anticipate a response to your second question within 120 days.

We hope that this satisfactorily responds to question one of your letter.

Exhibit 4
to
Regulatory Concerns Regarding Ownership of Aircraft

**U.S. Department
of Transportation
Federal Aviation
Administration**

MAR 9 2007

James W. Dymond, Esq.
Moore & VanAllen PLLC
430 Davis Drive, Suite 500
P.O. Box 13706
Research Triangle Park, NC 27709

RE: Request for Guidance and Interpretation Regarding "Flight Department Companies" and Part 91 Operations

Dear Mr. Dymond:

This responds to your letter dated December 28, 2006 that presents a scenario in which certain U.S. citizens desire to form a limited liability company ("Company") for the purpose of owning and operating a civil aircraft ("Aircraft"). The owner of the Company ("Client") will make contributions to the Company in the amounts needed to pay the costs of owning and operating the aircraft that will be used solely for the transportation of the Client, the Client's family members and guests for personal purposes. You request a legal interpretation to several questions:

(1) Would the Company be considered a "flight department company" by the FAA [Federal Aviation Administration]?

Yes, as that phrase has been used in FAA interpretations. A company whose sole purpose is transportation by air and receives compensation (amounts paid by the Client needed to pay the costs of owning and operating the aircraft) must obtain certification under Part 119 unless the aircraft has a maximum allowable payload of 6000 pounds or more than 20 seats, when it could operate under part 125. Section 91.501 (b)(4) is drafted to permit an individual owner, not a company, to operate an airplane for his own personal transportation and guests without charge. Thus section 91.501 (b)(4) cannot be used by a flight department company.

(2) If the FAA would consider the Company to be a flight department company, then would the FAA consider the contributions made by the Client to the Company in order to fund the operating expenses of the Aircraft to be "compensation" for the Client's personal transportation on the Aircraft?

Yes.

(3) If the answers to Question 1 and Question 2 above are both "yes," then could the Company's flight operations (based on the assumptions) properly be conducted under Part 91 pursuant to the "personal transportation" exemption described in 14 C.F.R. § 91.501(b)(4)?

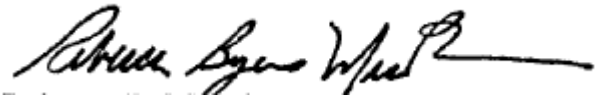
No.

(4) If the answer to Question 1 and/or Question 2, above is "no," then would the Company's flight operations (based on the assumptions) properly be conducted under Part 91?

No. Depending upon the number of different kinds of passengers this might constitute common carriage, in which case the FAA would require the company to obtain a Part 119 certificate and operate within the requirements of Part 121 or Part 135.

This response was prepared by Bruce Glendening, Attorney in the Regulations Division of the Office of the Chief Counsel and has been coordinated with the Air Transportation Division of Flight Standards Service. If you have additional questions regarding this matter, please contact us at your convenience at (202) 267-3073.

Sincerely,



Rebecca B. MacPherson
Assistant Chief Counsel,
Regulations Division (AGC-200

Appendix Item 2

NBAA Exemption 7897F

U.S. Department
of Transportation
**Federal Aviation
Administration**

800 Independence Ave., S.W.
Washington, D.C. 20591

March 22, 2013

Exemption No. 7897F
Regulatory Docket No. FAA-2002-12728

Mr. Douglas Carr
Vice President
National Business Aviation Association, Inc.
1200 18th Street, NW, Suite 400
Washington, DC 20036

Dear Mr. Carr:

This letter is to inform you that we have extended Exemption No. 7897, as amended. It explains the basis for our decision, describes its effect, and lists the conditions and limitations.

The Basis for Our Decision

On September 27, 2012, the Federal Aviation Administration (FAA) issued Exemption No. 7897, as amended to National Business Aviation Association, Inc. (NBAA). That exemption from §§ 91.409(e) and 91.501(a) of Title 14, Code of Federal Regulations (14 CFR) allows NBAA to operate small civil airplanes and helicopters of United States registry under the operation rules of §§ 91.503 through 91.535 and to select an inspection program as described in § 91.409(f).

Our Decision

The FAA has determined that the justification for the issuance of Exemption No. 7897, as amended, remains valid with respect to this exemption and is in the public interest. Therefore, under the authority provided by 49 U.S.C. 40113 and 44701, which the FAA Administrator has delegated to me, I grant your petition, subject to the following conditions and limitations.

Conditions and Limitations

1. Only those operations that are listed in § 91.501(b)(1) through (7) and (9) may be conducted under the authority of this exemption. Those operations must be conducted in compliance with the operating rules in §§ 91.503 through 91.535. However, helicopter operations are not required to comply with the flight altitude rules of § 91.515(a), provided the operations comply with the minimum safe altitude requirements in § 91.119. Aircraft operated under the authority of this exemption must use an inspection program listed in § 91.409(f).

2. No person may operate an aircraft under this exemption unless the appropriate Flight Standards District Office (FSDO) has been -

    a. Notified that the operation will be conducted under the terms of this exemption; and

    b. Provided with a copy of the time-sharing, interchange, or joint ownership agreement under which each aircraft is being operated, if appropriate. Each agreement must include the aircraft registration number of each aircraft involved.

3. No person may operate an aircraft under this exemption unless an entry is made in the aircraft logbook showing the provisions of part 91, subpart F, under which it is being operated.

4. No person may operate an aircraft under the authority of this exemption unless an inspection program has been submitted to and approved by the appropriate FSDO.

5. This exemption does not authorize the conduct of any operation required to be conducted under the rules of part 135.

6. This exemption is not valid for operations outside of the United States.

The Effect of Our Decision

Our decision extends the termination date of Exemption No. 7897, as amended, to March 31, 2015, unless sooner superseded or rescinded.

Sincerely,

/s/
John M. Allen
Director, Flight Standards Service

Appendix Item 3

Aircraft Time Sharing Agreement

AIRCRAFT TIME SHARING AGREEMENT

This Aircraft Time Sharing Agreement ("Agreement") is entered into as of this the _____ day of _____, 2013, by and between _____, a _____Corporation, having its principal place of business at _____, _____, _____ ("Time Sharor"), and

Name: _____
Address: _____
_____
("Time Sharee").

FOR AND IN CONSIDERATION of the mutual covenants and agreements contained herein, and other good and valuable consideration, the receipt and sufficiency of all which is hereby acknowledged, the parties hereto do hereby covenant, contract and agree as follows, to wit:

SECTION I - OWNERSHIP

1.1 Ownership. Time Sharor represents and warrants that it is the sole owner of the U.S. registered, large, multi-engine turbojet aircraft described as:

Make / Model:
Model Year:
Serial Number:
Registration:
("Aircraft").

1.2 Time Sharor's operation of the Aircraft is incidental to the business of Time Sharor.

SECTION II - TIME SHARING OF THE AIRCRAFT

2.1 Time Sharing. Time Sharor hereby provides the Aircraft to Time Sharee and Time Sharee hereby accepts from Time Sharor the Aircraft with flight crew. Time Sharee shall pay Time Sharor the costs and expenses described below in Section 2.3. It is the parties intention that this Agreement is a "time sharing agreement" as that term is defined at 14 C.F.R. § 91.501(b)(6) and (c)(1).

2.2 Term. The initial term of this Agreement shall begin on the ___ day of _____, 2013, and continue until _____, 2014. This Agreement shall automatically renew at the end of the initial term unless this Agreement is terminated by written notice by either party to the other party. Such notice of termination must be received by the other party not less than thirty (30) days prior to the end of the then current term of this Agreement.

2.3 Costs and Expenses Paid by Time Sharee. Time Sharee shall reimburse Time Sharor for the following expenses and costs of each specific flight taken by Time Sharee:

a. fuel, oil, lubricants, and other additives;

b. travel expenses of the crew, including food, lodging, and ground transportation;

c. hangar and tie-down costs away from the aircraft's base of operations;

d. insurance obtained for the specific flight;

e. landing fees, airport taxes, and similar assessments;

f. customs, foreign permit, and similar fees directly related to the flight;

g. in flight food and beverages;

h. passenger ground transportation;

i. flight planning and weather contract services; and

j. an additional charge equal to 100 percent of the expenses listed in paragraph (a) of this section.

k. the applicable FET on the sum of a – j above.

Time Sharor shall invoice Time Sharee for the above expenses within 10 days after the completion of the flight or series of flights. Such invoice shall detail by permissible category the charges incurred and include all Federal excise taxes and segment fees.

2.4 Time Sharor's Insurance. Time Sharor will maintain not less than $_____ of liability insurance.

2.5 Operational Control. Time Sharor shall maintain and exercise Operational Control over the Aircraft for all Flights. Operational Control includes, but is not limited to possession, command and control, and also shall include, without limitation, exclusive control over:

a. the flight crew and all crew members;

b. determining whether any particular flight may be operated safely;

c. assigning crew members to particular flights;

d. initiating and terminating flights;

e. issuing directions to crew members to conduct flights; and

f. dispatching or releasing of flights.

2.6 Authority of Pilot in Command. In accordance with the applicable governing regulations, the flight crew shall exercise its duties and responsibilities regarding the safety of each flight conducted hereunder. Whenever, in the sole discretion of the pilot-in-command, safety of flight may be compromised, the pilot-in-command may terminate a flight, refuse to commence a flight, or take any other action required for safety, without liability for loss, injury, damage, or delay. The pilot-in-command shall have the right to refuse to board or remove cargo or passengers whenever in his/her judgment the presence of such cargo or passengers would endanger the Aircraft, its cargo or passengers and shall have the right to select the route to destination; provided, however, that the shortest route which is safe and economical shall be followed.

2.7 All Other Costs. Time Sharor shall be responsible for payment of all costs and expenses not specifically charged to Time Sharee in this Agreement.

2.8 Aircraft Maintenance. Time Sharor shall be responsible for all Aircraft repairs and maintenance.

SECTION III - REPRESENTATIONS AND WARRANTIES

3.1 Time Sharor. Time Sharor represents and warrants to Time Sharee that:

a. It is the Owner of the Aircraft.

b. It is an entity duly and validly organized and existing in good standing and has the power and authority to enter into this Agreement.

c. It will not operate the Aircraft in transportation of passengers or cargo for compensation or hire.

3.2 Time Sharee. Time Sharee represents and warrants to Time Sharor that:

a. It is an entity duly and validly organized and existing in good standing and has the power and authority to enter into this Agreement.

b. It will not operate the Aircraft in transportation of passengers or cargo for compensation or hire.

SECTION IV – MISCELLANEOUS

4.1 Effect of Termination. Upon any termination of this Agreement, each party will be released from all obligations and liabilities to the other occurring or arising after the date of such termination and any liability arising from breach of this Agreement will survive termination of this Agreement. Neither party will be liable to the other for damages of any sort solely as a result of terminating this Agreement in accordance with its terms, except as specifically provided above. Termination of this Agreement will be without prejudice to any other right or remedy of either party.

4.2 Relationship of Parties. It is understood and agreed that the relationship of the parties hereto is strictly that of Time Sharor and Time Sharee, and this Agreement shall not be construed as a joint venture or partnership.

4.3 Agreement Binding on Assigns. All covenants, conditions and agreements and undertakings in this Agreement shall extend to and be binding on the respective heirs, successors, and assigns of the respective parties hereto the same as if they were in every case named and expressed.

4.4 Applicable Law. This Agreement will be governed by and construed in accordance with the laws of the United States of America, and the State of _____ substantive and procedural law will apply.

4.5 Severability. If for any reason a court of competent jurisdiction finds any provision of this Agreement, or portion thereof, to be unenforceable, that provision of the Agreement will be enforced to the maximum extent permissible so as to affect the intent of the parties, and the remainder of this Agreement will continue in full force and effect.

4.6 No Waiver. Failure by either party to enforce any provision of this Agreement will not be deemed a waiver of future enforcement of that or any other provision.

4.7 No Rights in Third Parties. This Agreement is made for the benefit of Time Sharor and Time Sharee and their respective subsidiaries and affiliates, if any, and not for the benefit of any third parties.

4.8 Attorneys' Fees. It is further understood and agreed by and between the Time Sharor and Time Sharee that if on account of a breach or default by either party of any of their obligations hereunder, it shall become necessary for the other party to employ an attorney to enforce or demand any of either party's rights or remedies, hereunder, then and in any such event, the defaulting or breaching party shall pay all reasonable and necessary attorneys' fees, costs of court and other expense occasioned by such default(s) and breach(es).

4.9 Counterparts. This Agreement may be executed in one or more counterparts, each of which will be deemed an original, but which collectively will constitute one and the same instrument.

4.10 Notices. All notices required to be given by either party shall be sufficient if giving in writing and personally served or sent by U.S. certified/registered mail to the last known address of the party.

4.11 Headings and References. The headings and captions used in this Agreement are used for convenience only and are not to be considered in construing or interpreting this Agreement.

4.12 Entire Agreement. This Agreement is the entire agreement between the parties and may not be modified orally or in any other manner other than by agreement in writing and signed by all parties or their respective successors in interest.

SECTION V - TRUTH-IN-LEASING

THE AIRCRAFT HAS BEEN MAINTAINED AND INSPECTED UNDER FAR 91 FOR THE PREVIOUS TWELVE (12) MONTHS.

IT WILL BE MAINTAINED AND INSPECTED UNDER FAR 91 FOR OPERATIONS TO BE CONDUCTED UNDER THIS AGREEMENT. DURING THE DURATION OF THIS AGREEMENT _____ IS CONSIDERED RESPONSIBLE FOR OPERATIONAL CONTROL OF ALL AIRCRAFT IDENTIFIED AND TO BE OPERATED UNDER THIS AGREEMENT.

AN EXPLANATION OF FACTORS BEARING ON OPERATIONAL CONTROL AND THE PERTINENT FEDERAL AVIATION REGULATIONS CAN BE OBTAINED FROM THE NEAREST FAA FLIGHT STANDARDS DISTRICT OFFICE.

I, _____, THE UNDERSIGNED _____ OF _____, A _____ CORPORATION, CERTIFY THAT _____ IS RESPONSIBLE FOR OPERATIONAL CONTROL OF THE AIRCRAFT AND THAT _____ UNDERSTANDS ITS RESPONSIBILITIES FOR COMPLIANCE WITH APPLICABLE FEDERAL AVIATION REGULATIONS.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed by their duly authorized representatives.

Time Sharor:	Time Sharor:
By:_____	By:_____
Name:_____	Name:_____
Its:_____	Its:_____
Date:_____	Date:_____

Appendix Item 4

Aircraft Purchase / Sale Form

AIRCRAFT PURCHASE / SALE

Aircraft:
- Registration:
- Manufacturer:
- Model:
- Serial Number:
- Manufacture Year:
- Engine Serial Number(s):
- APU:

Sales Price:
- Deposit:

Seller:

Seller's Attorney:

Buyer:

Buyer's Attorney:

Broker: Y/N
Lender: Y/N
Escrow Agent:
Escrow Agreement: Y/N

International Registry:
- Airframe: Y/N
- Engines: Y/N

Appointment of Administrator:
- Seller Y/N
- Buyer Y/N

1031 Exchange: Y/N

State Tax Exemptions:
- Sale for Resale
- Occasional Sale
- Domicile After Sale

Prebuy:
- Where:
- Time:
- Scope:

Fly Wire: Y/N

Insurance:
- Broker:
- Underwriter:

Ownership Structure:
- Partnership – All individuals
- LLC – Statement in Support

Corporation – Resolutions

Appendix Item 5

Closing Checklist

AIRCRAFT CLOSING CHECKLIST

_____
Purchaser

and

_____
Seller

Airframe

Manufacturer: _____

Model: _____

Manufacturer's Serial No.: _____

U.S. Registration No.: N_____

Engines

Manufacturer: _____

Model: _____

Manufacturer's Serial No.: _____

and _____

APU (if applicable)

Manufacturer: _____

Model: _____

Manufacturer's Serial No.: _____

Propellers (if applicable)

Manufacturer: _____

Model: _____

Manufacturer's Serial No.: _____

AIRCRAFT CLOSING CHECKLIST

*Documents to be pre-positioned with Escrow Agent prior to Closing

	DOCUMENTATION ITEM	PARTY TO DRAFT OR ACT	STATUS
1.	Identify Escrow/Title Counsel	All	
2.	Order FAA and International Registry ("IR") searches	Escrow Agent	
3.	Purchaser Registered as a Transaction User Entity ("TUE") with a PUE of Escrow Agent	Purchaser	
4.	Seller Registered as TUE for IR filings with a PUE of Escrow Agent	Seller	
5.	Aircraft Purchase Agreement	Seller/Purchaser	
6.	Assignment of Purchase Agreement (if different Seller or Purchaser from Purchase Agreement)	Seller/Purchaser	
7.	*FAA Form 8050-1 - Aircraft Registration Application	Seller	
8.	An LLC Statement in Support from Purchaser acceptable to the FAA (if Purchaser is LLC)	Purchaser	
9.	*FAA Form 8050-2 - Aircraft Bill of Sale from Seller to Purchaser	Seller	
10.	*Warranty Bill of Sale from Seller to Purchaser	Seller	
11.	*Declaration of International Operations (if applicable)	Purchaser	

12.	Purchaser's Lease Agreement (if applicable)	Purchaser	
13.	Notify FSDO of first flight under Lease and mail copy of Lease to FAA for Truth-in-Leasing requirements (if applicable)	Purchaser	
14.	Acceptance and Delivery Receipt (obtain fuel receipt at Delivery Location)	Seller/Purchaser	
15.	Tax exemption certificate for delivery location	Purchaser	
16.	Copy of Certificate of Airworthiness	Seller	
17.	Confirm insurance is in place	Purchaser	
18.	Authorize disbursement of funds	All	
19.	Authorize filing of documents	All	
20.	Place pink copy of Aircraft Registration Application and Lease on board aircraft	Purchaser	
21.	Post-Closing Title Search	Escrow Agent	
22.	Distribute file-stamped copies of all documents filed with FAA for closing	Escrow Agent	
23.	Send original closing documents to appropriate parties	Escrow Agent	

Appendix Item 6

Property Tax Allocations

TEXAS PERSONAL PROPERTY TAX
Aircraft Allocation Formulas

- Business Aircraft Allocation
  Tax Code 21.055

  $$\text{FMV} \times \frac{\text{Texas Departures}}{\text{Total Departures}} \times \text{Tax Rate} = \text{Tax}$$

- Commercial Aircraft Allocation
  Tax Code 21.05

  $$\text{FMV} \times \frac{(1.5 \times \text{Texas Departures})}{8760} \times \text{Tax Rate} = \text{Tax}$$

Example: Fair Market Value = $2,300,000
50 of 100 departures from Texas airports
Combined tax rate = 0.025%

- Business

  $$\$2{,}300{,}000 \times \frac{50}{100} \times 0.025 = \$28{,}750$$

- Commercial

  $$\$2{,}300{,}000 \times \frac{1.5 \times 50}{8760} \times 0.025 = \$492$$