



FRACTIONALS ARE NOT ALL CREATED EQUAL

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Fractional programs are not all created equal. Nor are all programs even “fractional” programs in the traditional sense. The fact is that some of the so-called “fractional” programs in existence today do not require fractional ownership.

In introducing its NetJets marketing concept to the business aviation market more than a decade ago, Executive Jet Aviation dubbed its concept “fractional aircraft ownership” in part because the program required each participant in the program to purchase a fraction (e.g., 1/8, 1/4, 1/2, etc.) of the ownership interests in a single aircraft. The original NetJets concept, now considered to be the “traditional” fractional ownership model, requires that each owner of a fractional interest in a particular aircraft agree to place the aircraft into a pool of aircraft, all of which are fractionally owned. The aircraft in the pool are then made available to all fractional owners in the program, with the total number of flight hours available to each fractional owner each year limited to a number that corresponds to such fractional owner’s ownership fraction (e.g., 100 hours per year for a 1/8 interest, 200 hours per year for a 1/4 interest, and so on).

This approach offers several advantages to users of business jet aircraft generally not available in the commercial charter market. For example, fractional ownership offers guaranteed service, on minimal notice, with consistency of make, model, and interior configuration. Programs that offer multiple makes and models allow easy swapping into larger or smaller aircraft, with all the same scheduling provisions. Most programs will pick-up or drop-off passengers anywhere the program operates and do not charge extra for ferrying the aircraft. Customers

who have long stays at their destinations may realize significant savings over the cost of chartering a similar aircraft by not being required to pay charges for ferrying, minimum daily charges, or crew out-of-pocket expenses ordinarily incurred when chartering an aircraft. As compared to whole aircraft ownership, fractional ownership may reduce an individual owner’s total costs of ownership and operations, depending on one’s circumstances.

As with any successful new idea, the traditional fractional concept has been emulated by numerous competitors. However, as the oldest traditional fractional ownership programs have matured and realized a significant market advantage, later entrants have identified the need to adopt innovative new ideas to attract customers. One innovative trend in the industry is to reduce barriers to entry into the market by reducing the up-front costs of entering a fractional program. Some fractionals have developed close relationships with leasing companies or private investors looking for tax benefits and who will purchase a fractional interest and lease it to the customer on an operating lease basis. Alternatively, the fractional program itself could acquire an aircraft and lease a fractional interest in the aircraft directly to the customer. These latter “leasing” programs will probably be operated under the commercial charter provisions of FAR Part 135, rather than the general operating rules of FAR Part 91 under which most other fractionals operate, and have historically been known as “block charter” arrangements. However, the advantage of a block-charter fractional is that it is essentially traditional charter (i.e., no up front costs), but with the guaranteed service and other scheduling and usage provisions typical of fractionals but generally not available in traditional charter.

Other innovations in the market today include a willingness of new entrants to offer a greater degree of customization of business terms and conditions to meet the needs of specific clients. For example, many fractionals are now offering shorter overall terms and easier early out provisions. If obtaining tax benefits is paramount to the customer, some new entrants can offer depreciation benefits associated with, for example, a 2-ownership interest, but which only anticipates 50 or 100 hours of usage. At least one fractional will “buy-back” unused flight hours from you and use the hours to charter the aircraft to third parties. Most recently, there is a new entrant with a turnkey structure to allow several parties to join together in a purchase of a small fractional interest. This company targets prospective customers with low annual flight hour requirements who otherwise might be excluded from enjoying the benefits of fractional aircraft ownership. Finally, helicopters are now available in the fractional marketplace. Business jet fractionals and helicopter fractionals are a natural to offer package deals, although we are not aware of any fractional programs that operate or yet offer both business jets and helicopters.

So, what will happen in the fractional industry in the next several years? Over the next several years, we can expect to see more innovation as new and small fractional programs search for ways to differentiate themselves from the larger, more established fractionals. A wave of mergers and consolidations is

also possible as regional-based programs join forces to compete on a national scale.

Greater price competition is also likely. Historically, fractionals have enjoyed higher overall margins than other sectors of the business aviation industry. Prospectively, as competition in the fractional industry increases, we are likely to see the margins in the industry come down to levels that will result in the average costs per flight hour of fractionally-owned aircraft being closer to those of fully-utilized aircraft in the non-fractional context.

So, is this a good time to acquire a fractional interest in an aircraft? Absolutely. There has probably never been a better time to enter the market. The number and variety of programs has never been greater, and the barriers to entry are getting lower by the day. Whatever your air transportation requirements may be, there is probably a fractional program that will work for you. It is important, however, to keep in mind that buying into a fractional program is a highly complex commercial transaction with serious tax and regulatory implications, and should not be undertaken lightly. It is, therefore, a very good idea to consult with an aviation attorney who has a thorough understanding of the fractional industry and the tax and regulatory ramifications of fractional aircraft ownership before buying into any fractional program.



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