



## Selling an Aircraft Position -By Keith G. Swirsky-



Prior to the economic downturn, the high demand for corporate aircraft created a large secondary, or gray, market for the sale of early aircraft positions. This high demand created an easy option for someone whose new aircraft needs had changed. The historic high demand also allowed these sellers to realize substantial premiums over their original contract price. Since these economic conditions had continued for a sustained multi-year period, speculators also entered the market. Not surprisingly, manufacturers realized the “speculation” issue, and several have modified the language in their contracts to attempt to prevent the “flipping” of their contracts.

The selling of aircraft positions remains an issue today in part because of the continued, albeit lesser, demand for large corporate aircraft, but mostly due to the economic downturn. Both aircraft owners and speculators want to shed themselves of continuing progress payments. In some cases, the liquidated damages are an acceptable sacrifice to terminate an OEM purchase agreement and in other cases, a buyer may still get out whole, because the market value of the aircraft equals or exceeds the contract price.

This article will focus on the various methods of selling an aircraft position. As will be seen, the process is more complex than is apparent and requires a thoughtful analysis.

### Assignment of Existing Contracts

We have not come across an OEM agreement that permits an assignment to a third party buyer without the consent of the OEM. Although some OEM’s have provided consent, and would even “encourage” you that they will favorably consider your request, it is more customary that the OEM will require significant financial inducement to approve a requested assignment. In today’s challenging aircraft markets, however, an OEM should be more likely than in the past to favorably consider such a request if the result is that the contract stays in good standing. Still, some economic inducement may be required.

### Sale of LLC Membership Interest

The first issue to consider in whether to purchase an unrelated party’s LLC membership interest is the contract language regarding assignment to third parties. Assignment to third parties is most often prohibited but a complete analysis must not end at that cursory



level of review. Most OEM agreements do not prohibit the purchase of LLC membership interest, and instead are silent on the issue. While one can argue that because such a sale is not prohibited, it is therefore no problem for the buyer. However, it can also be argued that a transfer of all of the LLC membership interests is a “defacto” assignment and contravenes the original intent of the parties. Suffice to say that in the event the seller is asking for money to be paid at closing that will not be retained in escrow to secure a claim of default by the OEM, then the buyer is at risk that, in the event of a dispute with the OEM, money paid to the seller is no longer available to be returned to the buyer.

If the contract was not executed in the name of a newly formed LLC, but was transferred from an existing active business to a subsidiary (pursuant to the “permitted assignments” paragraph), then the original party to the OEM agreement will remain liable under the OEM agreement. This is true because when doing a “permitted assignment,” the original party to the OEM agreement remains jointly and severally liable with the assignee. This will force the assignor/seller to continue to be part of the transaction to insure protection of its interests, in the event that the buyer subsequently defaulted and the assignor/seller was called upon by the OEM to perform under the OEM agreement.

Assignment language is only one concern in purchasing LLC membership interest. Often pre-existing LLC’s (or S corps) have had prior activity which may create unique problems. Aircraft positions are typically purchased in an active business with other assets, such as another aircraft. Or, the entity may have had a history of transactions or operations making the possibility of creditor or tax return issues surfacing in the future. Suddenly the buyer is faced with the added headache of due diligence to confirm that no financial surprises may arise that could attach to the ownership of the legal entity.

### Back- to- Back Title Transfers

When purchasing the LLC membership interests is not practical due to the contract language, prior history of the LLC, or other various reasons such as the refusal of the seller to leave money in escrow to secure a potential claim of default under the OEM agreement, it will become necessary to engage in a back-to-back title transfer. A back to back title transfer occurs at the aircraft’s closing, whereby the seller takes title to the aircraft as in a normal transaction, and immediately after taking title, a second FAA Bill of Sale is filed with the FAA which then transfers the aircraft to the buyer. The back to back title transfer allows the transaction to close without interference by the OEM.

The back to back title transfer is not without complications. Similar to the problems of assignment of the LLC, the seller may need to be actively involved in the transaction until title transfers. Progress payments, delivery location, and interior layout of the aircraft are among the many items that may need to be directed by the seller for the buyer. In particular with respect to progress payments, it is likely that the seller will want the buyer’s money to pay future progress payments. The buyer will not find this approach ideal, as their only rights are to take ownership of an aircraft that is being constructed for the seller, and the buyer has no direct rights against the OEM to demand a credit for amounts paid, and, most importantly, the ultimate delivery of an aircraft.



In addition, the required involvement of the seller vis-à-vis the OEM, makes the back-to-back title transfer a less attractive option in situations where the aircraft delivery date is far into the future. A possible solution to reduce the seller's involvement includes designating a mutually agreed upon third party, such as an aircraft completion specialist, or the buyer itself, to act as agent for the buyer vis-à-vis the OEM.

### Bonus Depreciation

Increased interest in the purchase and sale of aircraft positions may also be attributed to the revival of bonus depreciation. The recently passed American Recovery and Reinvestment Act of 2009 ("2009 Stimulus") contains provisions that appear to make it possible to receive bonus depreciation on an aircraft that has been transferred via the purchase of an aircraft position. The 2009 Stimulus extends the provisions of the Economic Stimulus Act of 2008 ("2008 Stimulus") which, in turn, resurrected bonus depreciation from the economic incentives Congress promulgated after September 11, 2001. A Treasury Regulation example indicates that where a taxpayer enters into a written binding contract prior to January 1, 2009 (September 11, 2001 in the example), and then subsequently transferred the rights to own and use the property to another unrelated taxpayer, the transferee taxpayer can qualify for bonus depreciation.

The use of the phrase "transferred the rights to own and use" in the Treasury Regulations is ambiguous, and it is not clear whether the phrase implies an assignment of the original OEM agreement, or a back-to-back title transfer of a new aircraft without an assignment of the OEM agreement, or both. A buyer should understand the strengths and weaknesses of claiming bonus depreciations under each of the discussed structures and should engage experienced aviation tax counsel to provide advice. It is also worth pointing out that the purchase by the buyer of an LLC that is disregarded for federal income tax purposes, is tantamount to an assignment of the underlying contract itself (for bonus depreciation analysis purposes). While the purchase of a seller's position seems at first blush a relatively straightforward and simple transaction, mainly due to the lack of a pre-purchase inspection as part of the process, this article demonstrates that it is far more complicated on the business issues associated with risks for each of the seller and the buyer. The attorneys at GKG Law have been involved, over the years, in over a hundred such structured transactions and can provide advice based on their expertise and practical experience.

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