Aircraft Ownership and Operations Planning

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Objectives of Proper Legal Structure

- Minimize State Sales and Use Taxes
- Maximize Federal Tax Deductions
- FAA Compliance and Liability Protection Planning

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Planning an Ownership Structure

✈Minimize Sales and Use Taxes

- Sales Taxes: imposed in the state where physical delivery of the aircraft occurs
- Use Taxes: imposed by the state(s) where the aircraft is "used and consumed" (e.q. hangared)

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Planning an Ownership Structure

✈Minimize Sales and Use Taxes

- Sales/use tax planning should be done first, as it is "form" over "substance" and provides the structural framework for the balance of the planning
- If an aircraft will be based in a state that imposes use taxes, there may be no net tax advantage to taking delivery in a no-tax state
- State of incorporation of the SPE will not create a tax advantage, but can create a disadvantage

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Planning an Ownership Structure

- Minimize Sales and Use Taxes
  - Common Exemptions and Exclusions:
    - Sale-for-Resale/Lease
    - Common Carrier – (e.q. Rolling Stock Exemption)
    - Interstate Commerce
    - Occasional/Casual Sale
    - Fly Away

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Planning an Ownership Structure

- Factor in Federal Tax Planning
  - Depreciation
    - MACRS vs. ADS
      - 5 year vs. 7 year double declining balance
      - 6 year vs. 12 year straight line
    - Recapture Issue

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Planning an Ownership Structure

- Factor in Federal Tax Planning
  - 280F:
    - Qualified Business Use = use in a trade or business
    - 50% test: more than 50% of the use of the aircraft must be Qualified Business Use

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Planning an Ownership Structure

- Factor in Federal Tax Planning
  - Deductibility of Operating Expenses
    - Ordinary, Necessary and Reasonable(Section 162)

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Passive Loss Rules under IRC 469

- Overview of Section 469: Why is Section 469 Important?
  - Depreciation and operating expense deductions may have little or no tax benefit:
    - Annual netting
    - Suspension of excess passive activity losses.
    - Carry forward until interest disposed
    - Results in deferral of losses that could be used to offset income from other sources.

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Passive Loss Rules under IRC 469

- Types of Passive Activities
  - Business activities in which the Taxpayer does not "Materially Participate"
  - Rental activities; Charter
    - Material participation is irrelevant, unless an exception applies

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✈Factor in Federal Tax Planning

- Personal and Entertainment Use
  - IRC Section 61 – SIFL
    - Income inclusion for individual
  - IRC Section 274
    - Limitation on corporate deduction

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Personal Use of Corporate Aircraft

✈When employee uses company aircraft for personal, non-business transportation --

- **IRS Rule**: <u>either</u>
  - employee must reimburse company for costs of the transportation, <u>or</u>
  - Company must impute fringe benefit income to employee for value of the transportation
- **FAA Rule**: company cannot accept reimbursement from employee under Part 91

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Personal Use of Corporate Aircraft

- In order to comply with both the **IRS Rule** and the **FAA Rule**, the company's only option is to impute fringe benefit income to the employee for value of the transportation

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Personal Use of Corporate Aircraft

- Two methods to determine value of the transportation for fringe benefit purposes:
  - Fair charter value method
    - Based on cost to charter comparable flight
  - Standard industry fare level (SIFL) method
    - Mathematical formula that factors in aircraft weight class, miles flown, status of employee as control employee or non-control employee, and number of guests and family members

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Entertainment Use of Aircraft

- Section 274 of the tax code limits deductions for expenses of aircraft used for entertainment, amusement or recreational purposes
- Allocates expenses to business and entertainment on a pro rata basis – calculations can be very complicated

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What is Entertainment?

- Sports events
- Hunting
- Fishing
- Golfing
- Travel to Country Clubs
- Skiing
- Resort Destinations

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What Activities are Personal, but do not Constitute Entertainment?

- Commuting
- Travel to a funeral
- Travel to for medical purposes
- Travel for charity work
- Travel for business other than that of the employer providing the flight
- Travel to meetings with personal advisors
- Transportation between homes not associated with entertainment

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Planning an Ownership Structure

- Factor in Federal Tax Planning
  - Federal Excise Taxes
    - Air Transportation Taxes
      - Domestic vs. International
      - Possession, Command and Control
      - Applicability to charges/bookkeeping entries for shareholder and related entity flights

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Planning an Ownership Structure

- Factor in Federal Tax Planning
  - Tax-Free Exchanges – 1031
    - Selling a fully depreciated aircraft can result in recapture gain, taxable at ordinary rates
    - Recapture can be avoided by structuring sale of old aircraft, and purchase of new aircraft, as a "Like-Kind Exchange"
    - Transaction form and timing are critical

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Planning an Ownership Structure

- Tax-Free Exchanges – 1031
  - Forms of Like-kind Exchange structures:
    - Forward
      - Qualified intermediary holds funds from sale of relinquished aircraft pending purchase of new aircraft
      - 45 days to identify new aircraft
      - 180 days to acquire new aircraft
    - Reverse
      - Prior to purchase of new aircraft, exchange accommodation titleholder takes and holds title to old aircraft until closing of sale to third-party buyer
      - 180 days to close sale of old aircraft

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Planning an Ownership Structure

✈FAA Compliance and Liability Protection Planning

- Corporate Attorneys, Risk Managers, and CFO's who lack corporate aviation expertise often consider liability protection planning first, and conclude (incorrectly) that a Flight Department Company is required to minimize risk.

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Planning an Ownership Structure

✈FAA Compliance and Liability Protection Planning

- Problems with Flight Department Companies
  - Limited opportunities for exemption from sales and use taxes
  - Impact on Insurance Coverage
  - FAA Civil Penalties
  - Federal Excise Taxes

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Planning an Ownership Structure

Examples

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Typical Flight Department Company Structure

PARENT

Air Transportation Services

SUBSIDIARY

- Primary business operated by Parent
- Subsidiary employs (or contracts for) pilots
- Aircraft owned (or leased) and operated by Subsidiary; Subsidiary incurs all expenses for operations
- Subsidiary has no other business operations

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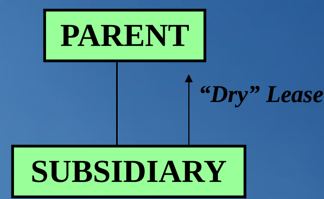
Typical Sale for Resale Structure (No Charter)



- Primary business operated by Parent
- Subsidiary owns (or leases) Aircraft, and leases (subleases) to Parent
- Parent employs (or contracts for) pilots, and operates Aircraft

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Typical Sale-for-Resale Structure (3rd Party Manager w/Charter)

- Primary business operated by Parent
- Subsidiary owns (or leases) Aircraft, and lease (subleases) it on a "non-exclusive" basis to both Parent and Manager
- Manager employs pilots and operates Part 135 flights
- Parent contracts for pilots and operates Part 91 flights

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Closing Remarks

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