



Options for Allowing Third Parties to Use Your Aircraft: *Income Tax, Excise Tax and Sales Tax Considerations*

Keith G. Swirsky

President, GKG Law, P.C.

kswirsky@gkglaw.com

202-342-5251

Christopher B. Younger

Principal, GKG Law, P.C.

cyounger@gkglaw.com

202-342-5295

Copyright © 2020 GKG Law, P.C.



GKG Law's Business Aviation Practice

About Us

GKG Law, P.C. is one of the leading firms worldwide advising clients on issues related to the business aviation industry. We are trusted counsel, having planned and structured thousands of aircraft transactions, and are well recognized federal aviation tax and regulatory issue professionals. GKG Law's mission is to provide our clients with legal counsel that is comprehensive, integrated, efficient and compatible with their business objectives.



In 2019, *Chambers High Net Worth* recognized **Keith Swirsky**, president of GKG Law and chair of the Business Aviation Practice, as a **top lawyer for private aircraft – global-wide**.

GKG Law's Business Aviation Practice

Our Services

GKG Law's reputation as an aviation law leader has been built on our valued relationships with clients and industry professionals, including brokers, consultants, financial advisors and business aircraft buyers & sellers.

We are committed to cultivating these relationships through our efforts to effectively, and without fail, represent, promote and protect the business interests of our clients and their associates.

GKG Law provides the breadth and depth of experience and comprehensive knowledge to address and represent a complete range of our clients' needs.



Aircraft Sales & Acquisitions



Loans & Financial Contracts



Federal Income Tax & Excise Tax Planning



Personal Use Guidelines & Calculations



Fractional Aircraft



State Sales & Use Tax Planning

Options for Allowing Third Party Use

Disclaimer

This presentation is being provided for general information and should not be construed as legal advice or legal opinion on any specific facts or circumstances. You are urged to consult your attorney or other advisor concerning your specific situation and for any specific legal or financial question you may have.

Options for Allowing Third Party Use

Upcoming GKG Law Webinars



▶ February 18, 2020

- “Structuring Personal Use of Corporate Aircraft Within the Framework of FAA Rules and Regulations”
 - Presented by Troy Rolf and Ryan Swirsky

▶ March 10, 2020

- “Defending a Federal (IRS) Income Tax or Excise Tax Audit or a State Sales and Use Tax Audit”
 - Presented by Keith Swirsky and Chris Younger

Options for Allowing Third Party Use



Overview

- ▶ During today's webinar we will summarize the basic requirements of the following options for allowing a third party to pay compensation for the use of your aircraft and discuss the Federal income tax, Federal excise tax, and state sales and use tax ramifications associated with the utilization of each option:
 - Part 135 Charter
 - Part 91 Dry Lease
 - Time Sharing under FAR Part 91.501

Options for Allowing Third Party Use

Tax Issues That Will Be Covered

- ▶ **Federal Income Tax – Deducting Expenses**
 - Trade or business (Code Sec. 162)
 - Depreciation schedule – 5/7 Year MACRS (Code Sec. 168(c))
 - Qualified Business Use (Code Sec. 280F)
 - Depreciation limitations – Personal Use (Code Sec. 274)
 - Passive activity loss limitations (Code Sec. 469)
- ▶ **Federal Air Transportation Excise Taxes**
 - Federal fuel excise tax credits
- ▶ **State Sales and Use Tax**
 - Sale for resale exemption
 - Common carrier/commercial aircraft/interstate commerce exemption
 - Sales tax on rent payments
 - Joint venture versus leasing issue

Options for Allowing Third Party Use

Part 135 Charter

- ▶ You lease your aircraft to an on demand air taxi (charter) operator.
- ▶ The charter operator operates the aircraft to provide a transportation service to third parties.
- ▶ Those third parties are customers of the charter operator and pay the charter operator fees for the transportation provided to them by the charter operator.
- ▶ The charter operator pays you a percentage or fixed amount of fees billed to its third party customers.

Options for Allowing Third Party Use

Non-Tax Advantages and Disadvantages of Part 135 Charter

▶ Non-Tax Advantages:

- The charter operator may charge third parties at any rate (in contrast to complex cost sharing allocations in Part 91 leasing structures and limitations on payment amounts that you may receive using the time sharing alternative, each of which will be discussed later in this webinar).
- Potential for enhanced liability protection planning by having third party operations conducted by the charter operator.
- Stricter operating and safety requirements imposed on charter operator.

▶ Non-Tax Disadvantages:

- The charter operator will generally earn a commission for its services.
- Added start-up expense to conform aircraft and aircraft documents for charter operations and ongoing additional crew training expense.
- Limited airport options available for aircraft operated under Part 135.
- Weather restrictions.
- Crew flight and duty time period rules/rest requirements.

Options for Allowing Third Party Use

Tax Considerations Part 135 Charter

▶ Federal Income Tax – Deducting Expenses

- May enhance arguments for deductibility of Code Sec. 162 trade or business expenses relating to aircraft.
- May extend aircraft depreciation schedule – 5 v. 7 Year MACRS/6 v. 12 Year ADS.
- Risk of Code Sec. 1245 recapture if depreciation schedule is extended.
- Must consider and analyze application of Code Sec. 469 passive activity loss limitation rules.
- Does not solve Code Sec. 274(e) personal entertainment use deduction limitation issues.
- May resolve Code Sec. 280F “qualified business use” requirements.

▶ Federal Air Transportation Excise Taxes

- Will apply to payments but may be offset in part by fuel excise tax credits.

▶ State Sales and Use Tax

- Common carrier/commercial aircraft/interstate commerce exemption may apply to lease rent.
- Need to consider impact on sale for resale exemption – joint venture versus leasing issue.

Options for Allowing Third Party Use

Part 91 Aircraft Dry Lease

- ▶ You lease your aircraft without flight crew to a third party.
- ▶ The third party lessee pays you rent for its use of your aircraft.
- ▶ The third party lessee, by virtue of the dry lease, becomes the aircraft operator when it uses the aircraft.
- ▶ The third party lessee must obtain its own pilots from a source unrelated to you.
- ▶ You and the third party lessee must agree how to allocate fixed and variable costs relating to the use of the aircraft by each of you.
- ▶ You and the third party lessee must have insurance coverage for each party's aircraft operations.

Options for Allowing Third Party Use

Non-Tax Advantages and Disadvantages of Part 91 Dry Leases

▶ Non-Tax Advantages:

- Greater operational flexibility for Part 91 lessee – more airports available, fewer weather restrictions, no FAA imposed crew duty limits.
- Less additional start-up expense because no need to conform aircraft and aircraft documents for charter operations and ongoing additional crew training expense.

▶ Non-Tax Disadvantages:

- Operations by each party must be incidental to or within the scope of another business conducted by such party.
- Number of Part 91 dry lessees is limited (usually recommend that no more than 3-4 leases be in place at any one time depending on relationship of lessor and lessees) to avoid issues with limitations on the provision of common carriage.
- Increased liability exposure for Part 91 lessee (and, potentially, for you).
- Need to design, implement and maintain a cost sharing relationship between all aircraft operators and ensure that costs are paid by everyone.

Options for Allowing Third Party Use

Tax Considerations - Part 91 Dry Lease

- ▶ Federal Income Tax – Deducting Expenses
 - Need to utilize arm’s-length pricing/rent to support deductibility of business expenses under Code Sec. 162.
 - Depreciation schedule should remain at 5/6 year non-commercial.
 - Does not solve Code Sec. 274(e) personal entertainment use deduction limitation issues.
 - Application of Code Sec. 469 passive activity loss limitation rules must be considered and analyzed.
 - May resolve Code Sec. 280F “qualified business use” requirements if you have an unrelated third party as the Part 91 lessee.
- ▶ Federal Air Transportation Excise Taxes
 - Amounts paid by Part 91 lessee should not be subject to FET.
- ▶ State Sales and Use Tax
 - Sales tax may apply to aircraft dry lease rent.

Options for Allowing Third Party Use

Aircraft Time Sharing

- ▶ Authorized under FAR 91.501(c)(1).
- ▶ You lease your aircraft with flight crew to a third party.
- ▶ The third party lessee pays you rent for its use of your aircraft.
- ▶ You operate your aircraft to transport the third party time share lessee.
- ▶ You charge for the flights conducted under the time sharing arrangement as specified in FAR 91.501(d).

Options for Allowing Third Party Use

Aircraft Time Sharing (continued)

- ▶ FAR 91.501(d) – charges cannot exceed (but may be less than) two times the cost of fuel, oil, lubricants, and other additives used during the flight, plus all of out of pocket expenses for:
 - Travel expenses of the crew, including food, lodging and ground transportation;
 - Hangar and tie down costs away from the aircraft's Operating Base;
 - Insurance obtained for the specific flight;
 - Customs, foreign permit, and similar fees directly related to the flight;
 - In-flight food and beverages;
 - Passenger ground transportation;
 - Flight planning and weather contract services.

Options for Allowing Third Party Use

Non-Tax Advantages and Disadvantages of Time-Sharing

▶ Non-Tax Advantages:

- Simplicity – ease of billing, no need to allocate costs.
- Same operational flexibility as with Part 91 dry lease – more airports available, fewer weather restrictions, no FAA imposed crew duty limits.
- Less additional start-up expense because no need to conform aircraft and aircraft documents for charter operations and ongoing additional crew training expense.

▶ Non-Tax Disadvantages:

- Number of Time Sharing lessees is limited (usually no more than 3-4 is recommended depending on relationship of lessor and lessees) to avoid issues with common carriage.
- Extremely limited ability to charge for cost reimbursement.

Options for Allowing Third Party Use

Tax Considerations Time Sharing

▶ Federal Income Tax – Deducting Expenses

- May affect deductibility of Code Sec. 162 trade or business expenses relating to aircraft – may trigger hobby loss analysis under Code Sec. 183.
- May extend aircraft depreciation schedule – 5 v. 7 Yr. MACRS/6 v. 12 Yr. ADS.
- Risk of Code Sec. 1245 recapture if depreciation schedule is extended.
- Does not solve Code Sec. 274(e) personal entertainment use deduction limitation issues.
- May be useful to avoid Code Sec. 469 passive activity issues that arise with the use of an aircraft dry lease.

▶ Federal Air Transportation Excise Taxes

- Will apply to payments but may be offset in part by fuel excise tax credits.

▶ State Sales and Use Tax

- Payments should not be subject to state sales and use taxes.



Keith Swirsky

President, GKG Law, P.C.

1055 Thomas Jefferson St. NW Suite 500
Washington, D.C. 20007

Tel: (202) 342-5251

Cell: (703) 597-5123

kswirsky@gkglaw.com

Christopher B. Younger

Principal, GKG Law, P.C.

1055 Thomas Jefferson St. NW Suite 500
Washington, D.C. 20007

Tel: (202) 342-5295

Cell: (410) 437-5356

cyounger@gkglaw.com

Copyright © GKG Law, P.C.

Worldwide Leaders in Business Aviation Law

www.gkglaw.com