Part 91 or Part 135?

It's a Board decision !

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Deciding to include Business Aviation as an element of transportation policy for a corporation is easy. Determining which regulatory structure—FAR Part 91 or Part 135—is more involved, notes aviation attorney Keith Swirsky.

There is no doubt that business aircraft can be useful tools that corporations can utilize to increase productivity and profits. The purchase of a business aircraft, however, is a major investment that typically requires approval of the Board of Directors. This article discusses part of the process that the Board will undertake once the decision to purchase the corporation's first business aircraft has been made.

Typically the first step in the acquisition process is the retention of an aircraft broker to locate a suitable business aircraft. The Board organizes a team of professionals, including an aviation attorney, staff accountant, CFO and treasury representatives, an aircraft management/charter company, and perhaps a commercial lender. As the process unfolds, the responsible parties will be bombarded with information, much of which will be confusing and overwhelming.

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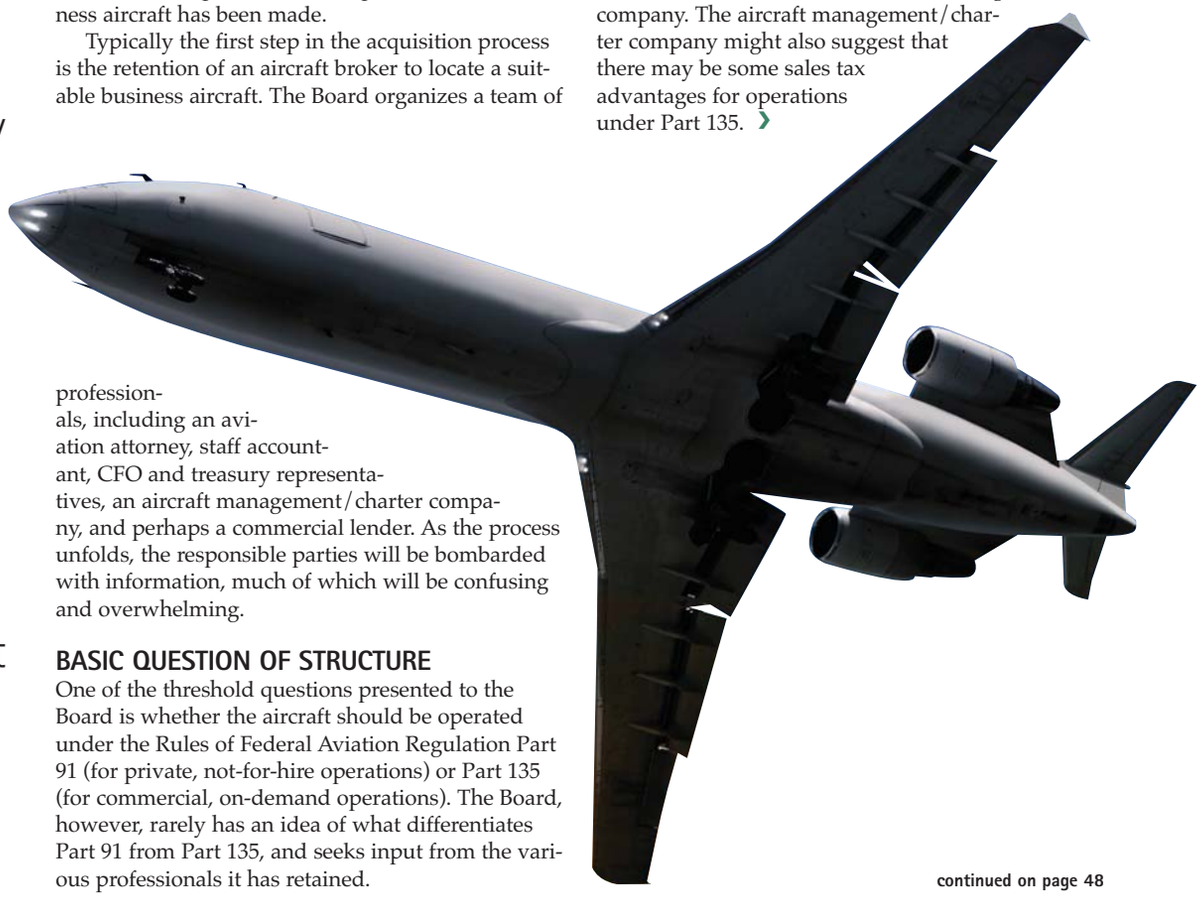
BASIC QUESTION OF STRUCTURE

One of the threshold questions presented to the Board is whether the aircraft should be operated under the Rules of Federal Aviation Regulation Part 91 (for private, not-for-hire operations) or Part 135 (for commercial, on-demand operations). The Board, however, rarely has an idea of what differentiates Part 91 from Part 135, and seeks input from the various professionals it has retained.

The aircraft management/charter company retained as part of the inquiry team may advise that the aircraft be operated under Part 91 for corporate flights. Alternatively, it might advise that the aircraft be operated at all times under Part 135 to ensure a higher set of safety standards, to provide liability protection planning, and to delegate complete operational control of the aircraft to the management company. The aircraft management/charter company might also suggest that there may be some sales tax advantages for operations under Part 135. ›



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UNDERSTAND THE PROS & CONS

The Board next turns to the aviation attorney on the team to develop an aircraft ownership and operating structure and to advise on tax related matters. Ordinarily, he or she will assume that aircraft operations will occur under Part 91, unless there is a compelling reason to operate under Part 135.

Part 91 offers the greatest operational flexibility under the Federal Aviation Regulations for the corporation, allowing the aircraft to operate out of any airport in the United States that supports the aircraft's performance capabilities, in any weather conditions that the pilots determine are safe, and during those hours that the company chooses to use its aircraft. Furthermore, the higher safety parameters associated with Part 135 can be "optionally" used by the company, rather than becoming mandatory.

In other words, Part 91 allows the company to establish policy for operating under the higher safety standards of Part 135, unless and until there is a need to deviate from a Part 135 requirement to accommodate a flight request.

Secondly, from a tax perspective, it is rarely true that Part 135 enhances the sales tax results (although, it is correct in a handful of states), and more importantly, there are significant negative Federal Income and Federal Excise Taxes associated with Part 135 for the corporation. (Specifically, Part 135 operations would trigger an obligation to pay Federal Excise Taxes, as well as cause a lengthened depreciation schedule and characterization of such depreciation under the passive activity loss rules.)

With respect to liability protection planning, one drawback of operating under Part 91 is that it puts operational control in the hands of the corporation, which means that the Board's corporation, rather than the aircraft management/charter company, will legally be considered the "operator" of the aircraft and will have liability associated with all aircraft operations. In contrast, Part 135 places operational control in the hands of the aircraft management/charter company.

To conclude that the company would not have liability solely on the basis that the aircraft management/charter company has operational control, is not possible. In all likelihood, in the event of an accident or incident involving the aircraft, the corporation would be involved in any litigation regardless of the Part regulating the aircraft's operation.

The preceding article scratches the surface on a very significant decision area associated with acquisition of a business aircraft by the corporation. The issues discussed within are not exclusively relevant to the question of aircraft operations under Part 91 or Part 135, and several hours of discussion among the team is always warranted in order to reach a balanced conclusion on this important question. Thus it is mandatory to have expert legal counsel.

Do you have any questions or opinions on the above topic? Get them answered/published in World Aircraft Sales Magazine. Email feedback to: Jack@avbuyer.com

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IRS SUSPENDS FET ASSESSMENT ON OWNER FLIGHTS OF MANAGED AIRCRAFT

by Keith Swirsky

Over the last several years, the Internal Revenue Service (IRS) has aggressively audited aircraft management companies and asserted that Federal Transportation Excise Tax (FET) applies to owner flights on aircraft that are managed by external management companies. The IRS has argued that the management company obtains "possession, command and control" of the aircraft, and is therefore providing a taxable transportation service to the aircraft owner, in circumstances where the aircraft management company employs the crew. There are a variety of additional factors the IRS has examined. However, the crew has been the predominant factor that has tipped the scales.

This audit activity took on a more aggressive pace once the IRS Chief Counsel issued an advisory opinion in March 2012, which set forth an explicit statement of the IRS' position on this matter and which further provided IRS auditors with a mandate to assess taxes. Since 2008, through and including May, 2013, representatives of the National Business Aviation Association (NBAA) and National Air Transportation Association (NATA) have been meeting with IRS officials to discuss this issue and to provide the IRS with industry information that might guide the IRS to a more informed position.

Effective May 16, 2013, the IRS announced that it is suspending further tax audit assessments of FET on owner flights of managed aircraft while the IRS and Treasury work on providing clear guidance on this issue. This interim position is a significant development, inasmuch as IRS assessments have equaled, at a maximum, 7.5 percent of the entire aircraft operating budget, which for a large cabin aircraft could easily equal a $150,000 FET assessment annually.

Despite the IRS' announcement, audits of management companies are continuing. Furthermore, they will need to be completed. Presumably, at the completion of each audit, the IRS auditor will request an extension of the statute of limitations and therefore will not issue a 30-day letter, deferring the need for an appeal.

What is the implication to an aircraft owner? Industry representatives will continue to work with IRS officials to develop a clear set of guidelines that does not hinge on whether the management company or the aircraft owner employs the crew. Yet, for those aircraft owners with significant annual operating budgets, it may be prudent to directly employ crew members while continuing with external management services.

Furthermore, it is prudent to review existing aircraft management agreements to ensure that they are well drafted from a regulatory perspective, particularly regarding "operational control" and "possession, command and control" matters, and most importantly to ensure that the agreement clearly identifies the management company as the aircraft owner's agent for the performance of all services rendered thereunder.

If you receive notice of an audit, you should not assume that the auditor will limit the scope of the inquiry as a result of the IRS' recent announcement or that there is no need to professional representation at the audit; instead, be cognizant of the fact that auditors continue to be tasked with making assessments, and that professional representation on the front end is critical.

Further updates will be provided as more information becomes available.