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Business Aircraft Ownership & Ops:

Common Mistakes, and How to Avoid Them.

In this two-part series, attorney Chris Younger describes several common mistakes that Boards make in connection with the acquisition and operation of business aircraft.

Forming a separate company to provide Business Aviation services as well as inadequate tax planning are addressed in this first part of our overview of common mistakes in business aircraft ownership and operations.

THE "FLIGHT DEPARTMENT COMPANY"

A Board of Directors often decides to form a new company, separate from the primary operating business, to own and operate a business aircraft and provide air transportation services to its employees and their clients. An entity formed for this purpose is commonly referred to as a "Flight Department Company".

A Flight Department Company typically employs, or contracts with third party vendors to obtain the services of flight crews, maintenance technicians, and other support personnel required for the operation of the business aircraft. Furthermore, a Flight Department Company provides air transportation services to the primary operating business and its affiliates operating its aircraft under Part 91 of the Federal Aviation Regulations (FAR). The primary operating business typically makes direct payments to the Flight Department Company to cover expenses of flight operations.

A Board often utilizes this structure in a misguided attempt to provide the primary operating business with a shield against any liability arising from an aircraft accident or incident.

However, a company that has as its primary purpose the ownership of an aircraft it operates to provide air transportation services to another person and receives compensation of any kind whatsoever for the provision of such services, falls within the regulatory definition of a commercial charter air carrier. Therefore, such a company must be certified to conduct aircraft operations in accordance with FAR Part 119 and must operate the aircraft under FAR Part 135.

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AVOID THE MISTAKES OTHERS HAVE SLIPPED UP ON.

Unfortunately, due to these FAA regulatory requirements, this theory of liability protection is seriously flawed.

Consequently, unless a Flight Department Company has obtained the requisite certification to operate as a commercial charter air carrier, it is operating the aircraft it owns in an illegal manner as an unlicensed charter operator. These operations can result in civil and criminal liability for the Flight Department Company, its owners and officers and the flight crew on board its aircraft. Such operations also may void any insurance coverage applicable to its aircraft. Furthermore, these illegal operations likely destroy the liability shield that the primary

continued on page 58

operating business intended to achieve by creating the Flight Department Company structure.

Fortunately, with careful advance planning, a Board can plan its aircraft ownership and operating structure in a manner that avoids the prohibition on the use of a Flight Department Company while still allowing it to meet most, or all of its liability protection planning objectives.

INADEQUATE SALES AND USE TAX PLANNING

Boards often fail to engage timely and thorough state sales and use tax planning with respect to an aircraft acquisition. Most states impose sales and use taxes on aircraft ranging from two to ten percent of the aircraft's purchase price. For equipment with a $20 million value, the potential sales tax liability can range from $400,000 to $2 Million. Therefore, one of the most important tasks for the Board to undertake is ensuring that neither the purchase of an aircraft nor its subsequent use create an unintended sales or use tax liability.

The first order of business is to ensure that the aircraft is delivered in a state with no sales tax or with an applicable exemption from sales tax. Some states exempt all aircraft sales from their sales tax. Also, many states have sales tax exemptions for aircraft delivered to a non-resident purchaser for prompt removal from the state (commonly referred to as a "fly-away" exemption). The key for the Board is to determine the closing location with the best sales tax result.

Aircraft purchasers often assume that purchasing an aircraft in a state that either has no sales tax or exempts the purchase from its sales tax will completely eliminate sales tax liability with respect to the aircraft. This supposition ignores the fact that every state that imposes a sales tax also imposes a complementary use tax on aircraft that are operated or stored in that state.

Regardless of whether the aircraft was delivered in a state where no sales tax was imposed, a use tax liability typically arises in the state (or states) where an aircraft is stored or habitually located. Therefore, contrary to popular belief, taking delivery of an aircraft in a state where no sales tax is imposed and owning the aircraft in an entity that is formed in a state without sales tax (e.g., Delaware) will not enable a company to avoid sales and use tax liability altogether.

A Board can create a plan for acquisition, ownership and operating of a business aircraft that eliminates or minimizes potential sales and use tax liability. However, once liability for sales or use tax has accrued, it is nearly always impossible to "unwind" the transaction and avoid the liability. Therefore, it is imperative that such planning be conducted prior to the acquisition of a business aircraft so that it can be implemented in conjunction with that acquisition.

Next month, attorney Younger will address federal tax issues as well as the need for adequate documentation pertaining to business aircraft.

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

Business Aviation and the Boardroom continues on Page 60

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