



Use of a Special Purpose LLC or “S” Corp to Own an Aircraft

Presenter: Keith G. Swirsky, President

GKG Law, P.C.

1054 31st St., Suite 200

Washington, D.C. 20007

kswirsky@gkglaw.com

www.gkglaw.com

Tel: (202) 342-5251

Fax: (202) 342-5219

Disclaimers

- 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 own situation and for any specific legal question you may have.
- IRS CIRCULAR 230 DISCLOSURE - To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.



→ Common Ownership Structure

- Form an LLC or S corp (referred to as an SPE) to purchase and operate an aircraft
 - SPE employs the crew, and pays all aircraft vendors
 - SPE is owned by one or more individuals; or
 - SPE is a subsidiary of an operating business
 - SPE has no other business activities or assets



→ Choice of Entity: LLC

- Lots of Freedom - Most common choice
- Check the box Regulations
 - An LLC which otherwise meets the requirements of an “S” corporation can elect to be treated and taxed as an “S” corporation
 - Unless an election is made to be taxed as a corporation, an LLC with at least two members will be taxed as a partnership
 - Unless an election is made to be taxed as a corporation, an LLC with only a single member (SMLLC) will be treated as a disregarded entity



→ Choice of Entity – S corp

- “S” Corporation Limitations
 - Must not have more than 100 shareholders
 - Married couples are automatically treated as a single shareholder
 - Shareholders must be U.S. citizens or residents, and must be natural persons, so corporate shareholders and partnerships are generally excluded
 - Must have only one class of stock
- Qualified Subchapter “S” Subsidiary (QSUB or QSSS)
 - A QSUB election is made when an S corp is owned by another S corp
 - A QSUB is disregarded for federal income tax purposes
 - Assets of the QSUB are treated as being owned directly by the “S” corporate parent



→ Perceived Objectives of SPE

- Liability protection planning
- Simplicity



→ Issues

- FAA:
 - Operations under FAR Part 91
 - Requirement that aircraft operations are “within the scope of and incidental to” the business of the company (other than transportation by air) 91.501(b)(5)
 - No charge of any kind may be made by the SPE
 - Exception for owner flown aircraft



→ FAA Definition of “Charge:

- FAA interprets “charge” very broadly
- Includes not only the payment of money, but the receipt of anything of value, and even the mere expectation of some benefit
 - Thus, there need not be an actual payment of cash
- Includes:
 - Capital contributions
 - Loans
 - Reimbursement of actual expenses
 - An accounting charge
 - Any *quid pro quo*



→ FAA Requirement for Operations by SPE Be Under FAR Part 135

- Even where sole recipient of the air transportation service is the SPE's own parent company, affiliates, or the individuals that own the SPE
- Part 135 provides an additional layer of regulation applicable to aircraft operations



→ Potential consequences of failure of SPE to obtain an FAA air carrier operating certificate and conduct operations under Part 135:

- Undermine liability protection planning
- FAA civil penalties
- Cancellation of insurance
- Denial of insurance claims



→ Issues

- Federal Excise Taxes
 - Is taxable transportation being provided by one person to another, resulting in a 7.5% federal excise tax? – IRC Section 4261(a)
 - Offset for fuel taxes paid of 17.5 cents per gallon



→ Issues

- Federal Income Taxes
 - Is there a trade or business activity with a profit motive, allowing for deductions of tax depreciation and operating expenses? – IRC Section 162



→ Issues

- State Sales & Use Tax
 - Is there a liability for sales & use tax on the purchase, or can this structure meet an applicable exemption or exception?
 - Casual or occasional sales exemption
 - Trade in credit
 - Common carrier
 - Interstate commerce

BUT NOT SALE FOR RESALE



→ Proper Legal Structuring – FAA Rules

- The FAA rules described before prohibit an SPE from *operating* an aircraft under Part 91
- The FAA rules **do not** prohibit an SPE from *owning* an aircraft under Part 91
- Thus, there are planning opportunities available in order to utilize an SPE to purchase an aircraft and nonetheless operate the aircraft under Part 91

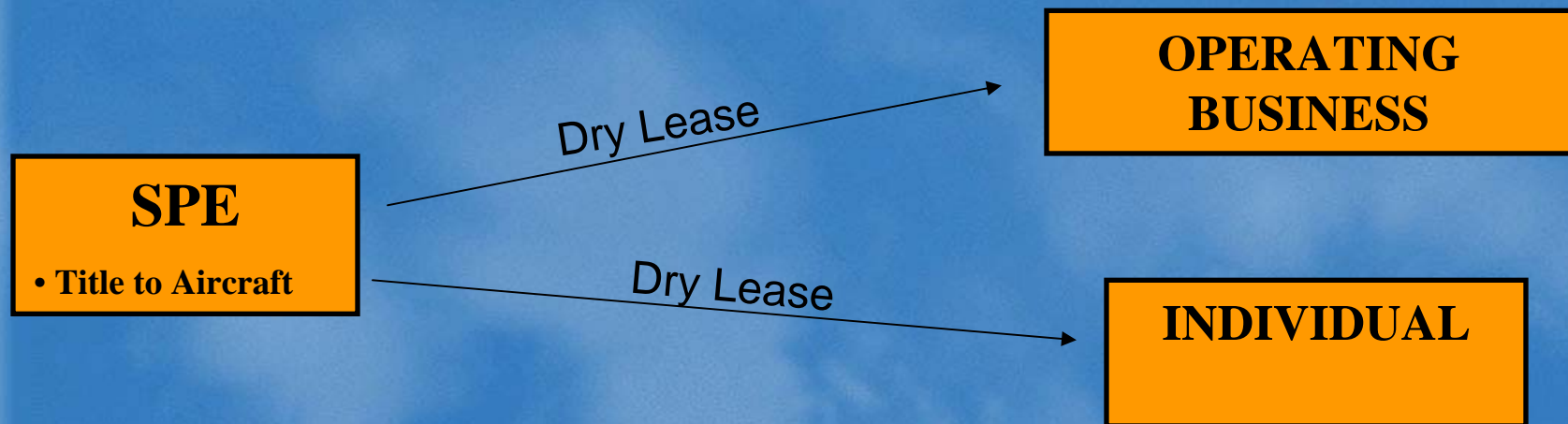


→ Proper Legal Structure – FAA Rules

- Use of a Dry Lease Agreement
 - A lease where the lessor (in this case the SPE) provides only the aircraft and not a flight crew to the lessee (in this case an operating business or an individual)
 - Operating business or individual must hire pilots and generally manage the operation of the aircraft
 - Operating business or individual, by virtue of the dry lease, becomes the operator of the aircraft



Diagram of Legal Structure:



- ➔ SPE owns the aircraft, and leases it to the operating business or individual
- ➔ Operating business or individual employs the pilots, and operates the aircraft



→ Federal Tax Planning and Opportunities

- Excise Taxes
 - No “taxable transportation” being provided by SPE
- Income Taxes
 - Operating business is likely a trade or business with a profit motive and can take as a deduction all ordinary and necessary expenses
 - Individual can report on Form 1040 business related expenses, subject to 2% of AGI limit that must be exceeded and AMT rules, which eliminate this deduction



→ Federal Tax Planning and Opportunities

- Income Taxes continued
 - SPE can be a subsidiary of operating business and disregarded for income tax purposes
 - If SPE is not disregarded, then must plan to avoid “per se rental” classification of leasing activity (and resulting passive activity loss)
 - Meet an exemption under Treas. Reg. 1.469-1
 - Make a grouping election under Treas. Reg. 1.469-4
 - If SPE is not disregarded, then “leasing company trap” can present problems on eligibility for accelerated cost recovery of depreciation



→ State Sales & Use Tax Planning

- Sale for Resale is most common planning mechanism
 - Compliance with proper FAA planning is consistent with sale for resale planning
- Dry lease undermines some sales tax planning opportunities, such as:
 - Casual or occasional sales exemption
 - Trade in credit
 - 6 month rules



→ Additional Planning Considerations

- Multiple Owners
 - Use of one SPE common planning technique for simplicity purposes
 - Use of multiple SPE's is document and bookkeeping intensive
 - Use of multiple SPE's provides better sales & use tax planning, and federal income tax planning opportunities
 - Use of multiple SPE's provides opportunity for all owners to conduct 1031 exchanges



→ Conclusion

- Melting Pot of Issues
 - It's a balancing of FAA, IRS, state sales & use tax, liability protection planning and economic cash flow considerations
 - Some planning structures may be stronger on federal tax considerations than state sales & use tax considerations or vice versa
 - There is no “one size fits all” answer and thorough planning is needed





Keith G. Swirsky

GKG Law, P.C.

1054 31st St., Suite 200

Washington, D.C. 20007

Tel: (202) 342-5251

Fax: (202) 342-5219

kswirsky@gkglaw.com

www.aviationtaxlawyer.com

