Avoiding Pitfalls in Business Aircraft Transactions

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Introduction

Q & A

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Introduction

How much does a pound of gas weigh?

Introduction

Is there an "e" in hangar?

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Introduction

Who has more hours flying KC-10s?

- Struble
- Norton

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Current Aircraft Market

Who knew?

- Drivers:
  - Pandemic health fears
  - New wealth
  - Pandemic supply chain
  - Used plane inventory (2021 – 800 / 2020 - 1600)
  - New plane (2 year backlog)
  - Pilot shortage (again?)
- Result:
  - Private jet flights up more than 50%
  - Selling used aircraft for a profit?
  - Netjets halted jet cards
  - Netjets - no fractional sales or leases for light cabin aircraft

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The Overview

- Purchase Agreements
- State Tax Considerations
- Aircraft Operations & Ownership Considerations

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Aircraft Purchase Agreements (APAs)

Letter of Intent (LOI)

- Non-Binding
- Sets forth Basic Terms of Aircraft Deal:
  - Aircraft price, deposit
  - Scope of pre-buy inspection and inspection facility
  - When the APA will be executed
- LOI drives APA business terms

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Aircraft Purchase Agreements (APAs)

<u>APAs</u>: Key Items to Include *or* Consider

- It is Binding – think past Basic Terms (taxes triggered by delivery, etc.)
- APA Specificity:
  - Airworthiness – define it
  - Pre-buy inspection criteria – list it
  - Who pays for what costs – specify it
  - Compliance with Aircraft Inspections, technical orders, etc. – outline it

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Aircraft Purchase Agreements (APAs)

- Pre-Purchase Expertise - technical aircraft expert or experienced broker valuable
- Marketable Aircraft Title / Aircraft Records
  - Adequate security to ensure good title/records
  - Single Purposes Entities:

Seller + "Seller's principal" =
Better Reps & Warranties

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State Tax Ramifications from Aircraft Transactions:

- State Sales Tax
- State Use Tax
- Property Tax

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State SALES Tax ("ST")

- State Sales Taxes Rules Vary Significantly:
  - By rates (Ex: some states have no ST) (AK, MT, NH, OR)
  - By application (weight (DE)), Purchase Price (OK)
  - By Fly Away Exemptions (FAE) (AZ, FL, KS, NB, TN, TX)
    - FAEs vary – pay close attention to time to remove from state
    - Clear and complete flight logs key to establish FAE
      - Written instructions important to pilots
    - Affidavit / declaration / exemption certificate

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<u>State SALES Tax (“ST”)</u> (cont.)

- Exemptions from ST payments vary, and can be dependent on
  - Occasional Sales Exemption (# of sales of personal property in certain time period)
  - Resale exemption

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State USE Tax ("UT")

- Aircraft sold in one state and used in another could be subject to UT in later state
- State UT rates varies from state to state
  - Some states have no UT
- Many states exempt UT based on different criteria, depending on state:
  - Predominant use outside of state (based on aircraft departures)
  - Certain use based on hours operated outside state
  - Time criteria of measurement may apply (e.g., the 1st year of aircraft operation)

State USE Tax ("UT") (cont.)

- Monitoring of use in and out of state(s) is key to determine UT application:
  - Accurate & detailed flight logs key
  - Monitoring and analysis of state(s) where large amount of flight time incurred is important

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Texas

- Sale for Resale
- 163.005 – (1) Close outside of Texas + (2) more than 50% out of state departures in first 365 days
- Occasional Sale

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State PROPERTY Tax (“PT”)

- Varies from state to state (some have no PT)
- PT rates & application vary
  - Some states assess % on aircraft value
  - Some states assess PT if aircraft involved in the production of any income
  - Some states assess PT on how aircraft is used (Part 91 vs. Part 135) in relation to aircraft value
  - Some PT assessed on statewide basis, on local basis, or both
  - Some PT assessed on number landings or takeoffs in relation to aircraft value
- Some states aggressive in tax collections (interesting partnerships as to tax collectors)
- Many times tax based on some percentage of aircraft value
  - Lower aircraft value, low tax

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State Tax Take Aways

- State taxes (one time and annual taxes) can increase aircraft operation costs
- Strategically analyzing aircraft operations to decrease state taxes requires planning and good record keeping
- Crazy alternative – pay the tax at closing and sleep well

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Aircraft Ownership and Operation

- Part 91 vs. Part 135 Operations
- Individual Ownership vs. Single Purpose Entities

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- Part 91 (Non-Commercial Private Air Transport)
  - No air carrier certificate needed
  - No compensation for air transport allowed
  - More operational flexibility

- Part 135 Operations (Commercial On Demand Operations)
  - Air Carrier Certificate Required
  - Compensation (broadly defined) for air carriage and transport allowed
  - More FAA regulations
  - 135 operator has operational control of aircraft (might not own aircraft)

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Part 91 (Non-Commercial) v. Part 135 (Commercial)

Pros and Cons

Part 91	Part 135
• Operational liability with the operator (dry lessee)	• Operational liability with certificate holder
• No specific crew time limits	• Crew duty time limits (14 hours duty / 10 hours flight time)
• No drug and alcohol testing required	• Drug and alcohol testing
• Less restrictive runway length and weather requirements	• Runway length, weather reporting restrictions
• Less FAA oversight	• More FAA oversight (heightened record keeping, equipment)
• Depreciation 5 years MACRS	• Depreciation 7 years MACRS
• No compensation unless you dry lease or meet an exception to no compensation rule (91.501)	• May receive compensation
	• 7.5% FET on charter rate (fuel tax credit partially offsets) (Not on owner used aircraft)
	• Texas – much more favorable local property tax treatment with commercial allocation
	• Conformity Inspection ($)

How Aircraft Are Held:

A. Single Purpose Entities (Ex: LLC):

- ➢ Part 91 – Major enterprise / primary business: not air transport
- ➢ Avoid Flight Department Classification if Part 91 operations
  - Dry Lease from LLC
    - Operational Control with Lessee
    - No FET

B. Individual Ownership

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