My Client is Buying an Airplane: Five Things Professional Advisors Need to Know

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Many lawyers, accountants and wealth managers have received that call from a client who says, "I plan on buying an aircraft, what should I be thinking about?" Or, worse yet, "I just bought an aircraft, is there something I need to do?" Unless you've encountered those situations frequently, you may be unprepared for the unique regulatory and planning challenges that come with a client who wishes to introduce an aircraft into their business. When your client calls, it's good to have at least a rough idea of some of those challenges. This article highlights five of the major areas that need your attention when you receive that call.

1. How the aircraft is owned and operated matters. Aircraft ownership and use are highly regulated by multiple government entities, and the wrong approach to owning and using the aircraft can cost your client dearly. For instance, non-aviation attorneys often advise clients to own the aircraft in a special-purpose company to avoid liability, but that advice can actually increase liability and violate federal law. If the client attempts to own and operate an aircraft from within a special purpose entity with no operating business, the Federal Aviation Administration (FAA) would identify all such usage as an illegal charter, which could result in the loss of a pilot's license and potential civil penalties for up to $1100 per flight. Further, the limited liability protections that owners often expect to find in that structure will not exist, because the company would actually be formed for an illegal purpose, which could result in either a piercing of the corporate veil or an insurance company excluding coverage after an accident. While it is possible to change and correct some of these issues after the fact, it is always worth planning how and where an aircraft is to be owned and used in advance of actually buying it.

2. Tax planning is also crucial. Choosing the right structure up front may allow your client to take advantage of potential tax benefits. A client may want to defer any sales taxes on the purchase or perhaps to maximize the opportunity for depreciation of the aircraft as a business asset. While these are both potentials, it may not be possible to do both, and decisions may need to be made. In addition, poor planning in the purchase can cause sales and use tax exposure in multiple states and the wrong structure can expose your client to Federal Excise Taxes (FET), the same as are charged on a ticket on Delta or United. If possible, it is best to identify your client's tax priorities upfront, before they take delivery of their aircraft.

3. Reimbursement of and deducting the costs of business use of an aircraft is more complicated than you know. There is a conventional wisdom among pilot owners that flight expenses may be shared with passengers or that, in other circumstances, their company can simply reimburse the pilot owner for flights taken on behalf of the company. While there is some truth to these ideas, the FAA and IRS rules are far more complicated than common wisdom. If a business owner operates her aircraft on company business, the owner can receive certain reimbursement, but she would be prohibited by FAA rules for being reimbursed for a flight carrying other people. In essence, the FAA would view her as providing transportation for hire, which requires a commercial pilot's license and a charter certificate. Sharing costs among passengers are limited to very particular circumstances and the FAA may otherwise view the money changing hands as providing transportation for hire. Another issue arises from mixing personal use and business use on a flight. IRS rules released in 2012 segregate aircraft use into three buckets – business use, personal non-entertainment use and personal entertainment use. Businesses need to understand that there can be significant disallowances as to the deductibility of expenses for personal non-entertainment use and personal entertainment use. The type of use for each flight needs to be tracked and will affect both the deductibility of the expenses by the company and potentially personal compensation for executives using the aircraft.

4. Personal use of business aircraft has limits and consequences. There are several methods by which an executive/owner may use company aircraft for personal use, but each has consequences for both the executive and the company. One common method tracks the use by flight leg and the individuals on the flights and treats the travel as an employee benefit. This method results in an executive's W-2 or K-1 income being grossed up to attribute the value of the flight to the executive. That "value" can be determined in one of a couple of ways, but if your client uses the IRS promulgated SIFL rates, those rates usually result in the lowest amount of income, which also limits the company's ability to deduct the costs of the flight to that attributed amount. Executives are also often surprised that they are prohibited by law from reimbursing the company for the costs instead and this fact can become a point of contention among different owners of a closely-held business or with executive compensation issues in a public company. There are other arrangements, such as time-sharing agreements that allow for limited reimbursement of the company but they involve the payment of federal excise taxes and require FAA truth-in-leasing compliance, among other requirements. Each model may impact both the deductibility of the flight costs and executive compensation, making it wise to plan the optimal approach for the particular situation in advance.

5. Beware the over-eager buyer. Sometimes a client calls to tell you that he is going to take delivery of an aircraft tomorrow, and "by the way, as soon as we close, we're taking my friends on a flight to Canada to go fishing." Not only does this bode ill for planning overall, but it also ignores the fact that there are regulatory issues that can delay the first usage of the aircraft for days or weeks after closing. For instance, if an aircraft is a large civil aircraft and is going to be owned by a special-purpose leasing company, the local FAA Flight Standards District Office (FSDO) needs to be given at least 48 hours advance notice under FAA truth-in-leasing rules so that it may inspect the leases and aircraft. If the buyer is purchasing an aircraft that will be operating at higher altitudes (between 29,000 feet and 41,000 feet), the aircraft will require a Reduced Vertical Separation Minimum (RVSM) system and each user must have an FAA approved manual and a letter of authorization for the system. Obtaining that letter of authorization could take days or weeks but the lack of it can require your client to fly at lower and slower altitudes and burn more fuel. Another concern is that, at closing, your client will only have a temporary registration that is only good for domestic use within the United States. If they are going to make that Canadian fishing trip, they need to apply for an FAA fly wire before they go, which can take 1 to 2 business days. None of these matters are difficult, but your executive will not be pleased to learn of them for the first time by being stopped by customs in Canada on the way north.

For better or for worse, aircraft use and ownership is often more complicated than clients imagine, but there are usually ways to work through or around the complications. A little advance planning can go a long way toward making the ownership and the use much smoother in all respects.

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