

# Important Clarification from the IRS for Owner Flights under Part 135 and its Impact on Aircraft Ownership Structure



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For every aircraft purchaser, there is a lot of time and thought that should go into the aircraft ownership and operating structure. Aircraft owners must consider both federal tax regulations and state tax regulations for the state where the aircraft will be based and also states the aircraft will be used frequently. In addition to the tax planning that should occur, there are also significant liability concerns an aircraft owner must take into consideration. Because an aircraft is a flying machine with millions of parts, the liability concerns for an aircraft owner are just as important, if not more so, as the tax planning. This is because when aircraft accidents or incidents occur, the payouts can be considerable and while the amount and type of insurance can reduce the liability concerns, strategic structural considerations can also help. Finally, and equally important to tax and liability considerations, is making sure the aircraft ownership and operating structure is in compliance with the federal aviation regulations (“FARS”), otherwise significant fines can occur or insurance policies can become void.

As described above, aircraft ownership and operating structure has three important factors: tax, liability and regulatory.

Just like a three-legged stool where each leg needs to be the same length, in aircraft ownership and operations planning, each factor must be given equal consideration. If one factor is focused on more than the other you could have an aircraft structure that does not work. For example, if the plan is created to provide a maximum amount of liability protection without understanding the constraints of the FARs, then the ownership and operating structure will likely violate the FARs. All three factors must be considered and often the final ownership and operating structure is a compromise between the three factors. At the end of the day the plan may not be the best plan from a tax or liability stand point but it is a plan that has adequate tax planning and liability protection, while still in compliance with the FARs.

The recent pre-publication final rule by the United States Internal Revenue Service (“IRS”) on the Tax Cuts and Jobs Act (TCJA) as it relates to aircraft management companies is helpful to owners because the factors do not require as much of a trade-off any longer. The rule states, among many other things, that when an owner flies on its own aircraft under Part 135, that the 7.5% federal excise tax (“FET”) does not apply. The final rule also clarifies that certain common ownership structure planning tools including owner trusts and qualified leases will also not be subject to FET for owner/lessee flown Part 135 flights when on the aircraft owned/leased. This final rule may change the ownership and operating structure plan for new buyers and for current aircraft owners. The rule also confirms that FET is not due on any management fees paid to a management company for its services.

In the past when an owner elected to fly flights on its own aircraft under Part 91, even when engaging a full-service management company, it did so as part of its ownership and operating structure plan to avoid FET on owner flights. However, it was a trade-off because when an owner flies under Part 91, the owner of the aircraft has operational control and therefore more potential liability. However, now, under the IRS rules, if an owner hires a full-service management company that has a Part 135 certificate, the aircraft owner may elect to have all of its flights flown under Part 135, with the management company in operational control and not have to pay FET. Under the IRS rule, FET is not applicable on owner flights when owner is flying on its own aircraft. The forgoing applies to the aircraft owning entity or another entity that qualifies under the rule, such as a beneficiary under an owner trust or a lessee under a qualified lease.

With the recent pre-publication final rule by the IRS related to the TCJA as it relates to aircraft management companies, new aircraft purchasers may have to make fewer compromises during its aircraft ownership and operating structure planning. Additionally, current aircraft owners may consider restructuring their ownership and operating structure to take into account the new IRS rules related to FET. ■

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