



## **BUYING YOUR PLANE IN THE U.S.**

### **It`s not just about tax! What you really need to know before you buy.**

For anyone thinking of buying an airplane, one of the first things they may seek advice on is tax. Although this is understandable, there are other issues which U.S. buyers need to consider before they tackle the taxation side of things.

We spoke with David Norton, a leading U.S. aviation lawyer who owns and flies his own plane. *“If you start with tax, I can almost guarantee that you are going to end up with a structure that the FAA considers to be a commercial operation, and if not done correctly will be viewed as an illegal charter operation,”* he comments. Rather, Norton explains, the first question should always be, *“Who is going to be the registered owner?”* It`s worth knowing that you have to be a U.S. citizen to place title to your aircraft on the U.S. civil registry - and that the definition of who qualifies as a U.S. citizen for this purpose is very tight.

The second question to ask is *“Who will be the operator of the aircraft?”* says David Norton, whose Quaynote masterclass on buying and operating your plane in the U.S. launched earlier this year. *“It`s worth spending time on this,”* he continues, *“as most people mess this one up.”* Usually, the operator is either the registered owner, or some person or entity who has taken over the operational control of a plane, usually in the form of a lease. *“Whoever has operational control over the plane is ultimately responsible for the safe conduct of that flight,”* David Norton concludes.

Once our buyer has worked out who has operational control, the next question is *“Will ‘compensation’ occur?”* Why should we care if compensation is occurring? *“Under the FAA rules, if I as operator (meaning I`m either the registered owner or a party that has assumed control under a lease), put anyone on that plane who is not a pilot, and then I as the operator is receiving any form of compensation, then I have become a commercial operator,”* explains Norton. A commercial operator in the U.S. is subject to very different rules, so there is indeed good reason to care about whether compensation is occurring!

In the states, you will hear people talking about Part 91 and Part 135. These rather dry-sounding terms are nonetheless critical to understand. They dictate what you can and cannot do with your plane in the U.S. and the level of FAA regulation a plane will be subject to. *“Part 91 sets the minimum regulatory floor for flying a plane. It`s highly regulated – but in a sense it`s not,”* explains David Norton. *“If you are operating under Part 91, then you have a lot of obligations with respect to the safe operation of the aircraft, but you are going to have very little direct interface with the FAA under which they are looking at you to ensure those obligations are being met.”*

If, however, our airplane owner becomes a commercial operator, then they then have to comply with Part 135. *“The moment you step into the world of Part 135, you now have to get a license – what the FAA calls an air carrier certificate – to be permitted to conduct those commercial operations,”* observes Norton. *“Once you have your air carrier certificate, you`re going to have additional maintenance requirements, as well as additional technical and pilot training requirements.”* What`s more, if you fly around the United States, while there are several thousand runways that you can land on under Part 91 operations, the number available to Part 135 operators goes down to several hundred, so it is much more restricted. *“That`s not necessarily a bad thing,”* David points out, *“it`s just that it`s a different regime that you need to be aware of and follow.”*

So, the question becomes, if you want to remain Part 91, how do you do that? *“You basically need to pass a three-pronged test to do that,”* states Norton. The first prong is to determine that the operator has a *“trade or business”* or *“a major enterprise for profit”* in the language used by the FAA that is not simply air transportation. In other words, it must be a company in its own right that supplies goods or services, rather than just an entity set up to operate a plane.

Prong 2 is that you have to fly the plane *“incidental to and within the scope of”* that true non-air-transportation trade or business. For instance, explains David Norton, *“if you are a widget manufacturer, then the primary use of the aircraft must be flying the plane in the course of running that widget manufacturing business.”*

Prong 3 is that you are paying for that plane out of the proceeds of that business, be it widget manufacturing or whatever your business is, with no compensation or reimbursement of any kind or in any amount occurring from some other person or entity – even if they are affiliated and even if it is simply sharing some of the costs. *“If all your company is doing is flying aeroplanes, then you will be considered a commercial entity because you failed the first prong – your company does not have a trade or business but is instead an air transportation company”* states Norton. *“Likewise, if the airplane isn’t actually used for the non-air-transportation, or even if it is sharing fuel costs, then it has failed the three-pronged test.”* In such a situation, the FAA is going to ask *“why are you not flying under Part 135?”* Norton points out that an entity that fails the first prong – one that is set up purely to fly planes for the benefit of its owners or third parties – is known as a *“flight department company.”* Norton continues that *“the FAA has been very clear since the 70s that if you set up a flight dept company, then you have to fly under Part 135.”*

David Norton has another word of warning for aircraft buyers regarding illegal charter. *“About 5 years ago, the FAA realised that they had been neglecting the issue of illegal charter,”* he recounts. This can take the form of improper dry leasing, where an operator is making both a plane and the aircrew (either directly or indirectly as a package deal) available for others without a proper charter certificate. *“Since then, there have been over US\$ 18 million in civil penalties imposed by the FAA for these unauthorized charters and related rule violations,”* he cautions.

The next thing to consider is civil risk. In the US, when there is an air incident or accident followed by a negligence claim, the operator is the party that is generally liable for any harm that arose from that incident or accident. How do you manage that risk? David Norton points to a popular solution, whereby *“You can put the aircraft in a holding company, then lease it to an air carrier and let them fly the plane for you.”* What this means is that you are then flying on your own airplane as a passenger. The charter company becomes the operator, who will be responsible for the flight. *“That only works if the owner can live under the Part 135 rules,”* Norton adds, *“which as we have seen, are more restrictive.”* There can also be some increased costs involved in operating under Part 135 which such as extra pilot training, etc.

Some plane owners will prefer to have the flexibility that Part 91 offers. In this case, says Norton, *“it’s important to (a) understand the rules outlined above and make sure you are following them, (b) realize that you will be liable so you need to do the appropriate due diligence to help ensure you are not acting in a negligent manner, and then (c) have the right insurance policy in place should an allegation or negligence is raised.”* This should comprise two key parts. *“First, it must have the hull policy and the second, more important aspect is the personal injury to third parties.”*

If you're flying a mid- to large-sized corporate jet, David reckons you will need at least a \$100million and maybe up to \$300million of coverage, depending on the size of the aircraft. While saying this, David Norton is keen to dispel a popular misconception. "People say to me, "Oh I'm going to get sued for everything I'm worth," he recounts. "And I say to them no. To be blunt, you'll get sued not on what you are worth but on what your **passengers** are worth!" Therefore, a big part of your risk analysis for operating under Part 91 is working out who your passengers are going to be. Will they be employers, clients, family? "If you are loading up the plane with your ultra high net worth friends, then that is a different story in terms of your risk analysis than if only you or your employees are on the aircraft" cautions Norton.

We started out talking about tax. For U.S. buyers, as you've seen, there are a whole host of other issues to tackle first. To find out more about all the hurdles to jump when purchasing a plane state-side, Quaynote's masterclass, "So you want to purchase an aircraft?" by David Norton, is available to sign-up to now on our website at [www.quaynote.com](http://www.quaynote.com).



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While his firm offers a broad array of legal services, Mr. Norton focuses solely on aviation law, having an internationally recognized practice that encompasses a broad range of business aviation regulatory, risk management, transactional, tax, and commercial dispute resolution matters. He is a frequent speaker at various business aviation conferences addressing current hot-topics in the industry.