



HOW TO SHARE A BUSINESS AIRCRAFT IN A SINGLE LLC

ELECTING OUT OF SUBCHAPTER K PROVIDES TAX BENEFITS WHILE REDUCING REGULATORY COST

Aviation, legal and tax professionals have historically encouraged joint owners of aircraft to hold their respective interest in the title. The FAA has allowed for co-ownership of aircraft in its registration process, and issued interpretations as to how these aircraft may be operated. The FAA specifically allows one co-owner to provide pilot services to fellow co-owners without violating the prohibitions banning the sale of transportation services by FAR Part 91 Operators. Joint owners of aircraft generally come together for the purpose of reducing fixed cost and sharing the efficiencies of ownership. However, if the joint owners conduct business as a partnership the nature of the use by one partner may impact the deductibility and basis of the others.

The use of co-ownership rather than partnership simplified the procedure of sale. The seller was forced to pay tax on the gain upon sale, and the purchaser received a new basis equal to the consideration paid for the asset. It was simple, straight forward, and fair. On the other hand, if the partnership rules apply, it was generally necessary for the partnership to make a special election to allow for adjustment in basis, or worse, depreciation might be suspended or disallowed to the purchasing partner. The message was abundantly clear to practitioners - beware of complex partnership provisions that might inadvertently impact the deductibility of aircraft use, or reduce value upon sale.

AND THEN ALONG CAME CAPE TOWN

The Cape Town Convention is an international treaty to which the United States is a party which includes an aircraft protocol for 8-person aircraft and 550 hp or greater engines. Interest in qualified aircraft must be registered in an international registry and include such objects as security agreements, lease agreements, sales agreements, amendments, extensions and the like. Even the International Registry itself admits they are unsure about how to register fractional interest. What is clear, however, is that it is expensive, complex, and far too burdensome to be required for each co-owner in the aircraft. If the benefits of joint ownership could be acquired through holding an aircraft in a single entity, it could greatly simplify both Cape Town registry requirements and FAA filings.

BY ELECTING OUT OF SUBCHAPTER K OF THE INTERNAL REVENUE CODE, ADVERSE PARTNERSHIP RULES MAY BE AVOIDED.

Partnerships have long been a vehicle of choice for tax shelters; and both Congress and the IRS have attacked them with some of the most complex anti-abuse legislation found anywhere in the Internal Revenue Code. Unfortunately, these anti-abuse provisions impact even the most benign business transactions, such as the transfer of an interest in an aircraft among partners.

If an entity is formed merely to hold legal title to property for the benefit of its owners, it may be possible to avoid partnership complexity and treat each partner as holding an undivided interest in the aircraft itself. Such treatment requires an election under Regulation 1.761-2 of the Internal Revenue Code and prohibits the joint conduct of a trade or business. This treatment would be particularly appropriate when one partner chooses to use his share of the aircraft for business, and the remaining partner for personal use. The business partner would be entitled to depreciate his share of the aircraft, while the personal user will preserve his income tax basis upon his ultimate sale.

IT MAY ALSO REDUCE SALES AND PROPERTY TAXES

For income tax purposes, a partner's interest in a partnership that elects out of Subchapter K treatment is treated as transferring an interest in the underlying aircraft upon sale. In most states, the transaction would not be subject to sales tax in that the transfer would be treated as a sale of an intangible asset and therefore exempt. In jurisdictions where property is revalued upon sale, it may also be effective in reducing property tax because legal title to the aircraft wouldn't change.

SIMPLE IS GOOD

Electing out of Subchapter K will not be available to all aircraft owners. It may also require less restrictive limitations on transferability of interest than some would prefer. Nonetheless, increased regulatory and tax burdens should challenge traditional thinking and encourage consideration of disregarded entities.

The most appropriate vehicle of choice remains the limited liability company. Whether the owner elects to be taxed as a partnership, or to elect out, it provides the ultimate in flexibility and liability protection from fellow members.

For further information, readers are encouraged to review 3 articles on our website www.advocatetax.com regarding joint ownership and operation of aircraft from a tax, FAA, and liability perspective. The underlying rationale in these articles would apply equally to co-ownership achieved through a disregarded LLC.

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