



The Flight Department Company Trap

Operating an Aircraft in a Sole Purpose Company?

By Kali M. Hague

Thinking of operating an aircraft in a sole purpose company to minimize liability? Think again. One of the most frequently violated FAA regulations is also one of the most well-known, but misinterpreted, provisions. As a general rule, Federal Aviation Regulation (FAR) Part 91 operators may not charge or accept reimbursement for flights. Owners and pilots forget that the regulation is not limited to unrelated third parties.

Earlier this year, an owner-pilot presented this scenario: To reduce ownership and operational costs, the pilot partnered with a friend to purchase a Bonanza. They created a new LLC (AircraftCo) to jointly own the aircraft and segregate its associated liability from their personal assets. The pilots were not yet qualified to fly the aircraft under their insurance, so they planned to hire pilots through AircraftCo. AircraftCo would then fly for their respective companies. The pilots knew that they could not directly pay the LLC for the flights without

violating the FARs, so they planned to make capital contributions to AircraftCo to cover their anticipated costs – fuel, maintenance, hangar, pilots, etc. AircraftCo did not have any other ongoing business. The pilots were surprised to discover that the AircraftCo, LLC structure is an illegal flight department company and a clear-cut violation of the FARs. Had they implemented the structure, they would have jeopardized their pilot’s licenses, aircraft insurance, and risked incurring pricy FAA fines.

To stay legal, steer clear of the flight department company trap in two steps:

Step One: Compensation and Operational Control

In many industries, high-liability assets are segregated from the primary business by operating the assets in sole purpose entities. In aviation, this practice is referred to as a “flight department company,” and the structure violates FAR Part 91. What makes the flight department company illegal is that the sole purpose entity has operational control of the flights and receives compensation. Operational control is defined as the exercise of authority over initiating, conducting, or terminating a flight. When a flight is flown for compensation or hire, the entity with operational control is generally required to be a commercial operator (for example, a charter company). Flight department company operations may not appear to be for compensation or hire because the aircraft operations likely do not generate revenue. However, the FAA defines compensation so broadly that even a capital contribution to fund aircraft operations is compensation.

The key distinction, and the touchstone between legal and illegal operations, is whether the sole purpose entity is operating or merely owning the aircraft. In the AircraftCo example, the entity is operating the aircraft because it provides an aircraft and flight crew. If AircraftCo’s function was limited to owning the aircraft (and even paying for maintenance, insurance, and fuel) but not providing or paying for pilots, AircraftCo would remain legal because the FAA does not object to owning an aircraft in a sole purpose entity.

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For pilots of owner-flown aircraft, a common structure involves owning an aircraft in a sole purpose entity and then dry leasing the aircraft to the owner-pilot or the owner-pilot's company. This structure does not create a flight department company because the sole purpose entity merely owns the aircraft. Private pilots must also comply with the requirements of FAR 61.113, which limits when a private pilot may accept compensation for acting as pilot in command of an aircraft. This regulation is especially pertinent to a private pilot operating an aircraft in connection with a business.

**Step Two:
Major Enterprise Test**

The flight department company trap is avoided when the carriage by air is incidental to the business operating the aircraft. When an entity that owns an aircraft has additional business functions, the "major enterprise test" applies to determine whether the flight operations are independently a major enterprise for profit or merely incidental to the ongoing business of the company. To determine if the flight operations are incidental, the company should take away the flight operations and see what business is left. When substantial, revenue-generating, business operations remain, the flight operations are likely incidental to the ongoing business. For example, if an aircraft is purchased by an architectural firm to transport the president to and from meetings, the aircraft flight operations are likely incidental to the architectural firm's business.

**Consequences of
Operating in an Illegal Flight
Department Company**

Instead of isolating liability, an illegal flight department company can trigger hundreds of thousands of dollars in FAA fines. Additionally, the structure generally violates aircraft leases, and may result in suspension or revocation of the pilot's airmen

certificates. It can also lead to federal excise tax (FET) assessments by the IRS. In the event of an incident or accident, the insurance company will likely deny coverage because the flight operations were illegal.

While owning an aircraft in a sole purpose entity complies with FAA regulations, an aircraft should never be operated in a sole purpose entity under FAR Part 91. Working with experienced aviation counsel will help aircraft

owners or potential buyers steer clear of common pitfalls in aircraft structuring. The worst time to discover that an ownership structure is inadequate is after an aircraft incident or accident.



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