Thinking of operating an aircraft in a sole-purpose company to minimize liability? Think again. One of the most frequently-violated FAA regulations is found in 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 who was upgrading from turbine to jet presented this scenario: To reduce ownership and operational costs, the pilot partnered with a friend to purchase the aircraft. 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. This AircraftCo entity 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 at the start of each year 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, negated aircraft insurance, and risked incurring pricey 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. The assets are legally separated but are still controlled by the same individuals that manage the primary business. In aviation, this practice is referred to as a “flight department company,” and the structure violates the FARs. What makes the flight department company illegal is how the aircraft is operated. The FAA does not object to owning an aircraft in a sole purpose LLC. The issue is that the company 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. Anytime a flight is flown for compensation or hire, the entity with operational control must be a commercial operator (flights for compensation or hire may also fall under one of the narrow exceptions in FAR Part 91). The commercial operator is generally a FAR Part 135 charter company.

While the FAA regulation that only commercial operators may accept compensation is straightforward, the application of the rule is surprisingly complex. Flight department company operations may not appear to be for compensation or hire because the aircraft operations likely do not generate revenue (readers who are aircraft owners know that aircraft never generate revenue). However, the FAA defines compensation so broadly that even capital contributions to fund aircraft operations are compensation.

**Step Two – Major Enterprise Test.**

To avoid the flight department company trap, the carriage by air must be 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 on-going business. In the owner-pilot example, if sufficient business is contributed to AircraftCo, LLC, the aircraft flight operations may be incidental to that 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 airman certificate. 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.

Aircraft owners should never operate an aircraft in a sole-purpose entity unless that entity holds a FAR Part 135 certificate. FAR Part 91 operations in a sole-purpose entity are always prohibited. Working with experienced aviation counsel will help aircraft owners or potential buyers steer clear of common pitfalls in aircraft ownership structuring. The worst time to discover that an ownership structure is inadequate is after an aircraft incident or accident.

Kali Hague is an attorney with Jackson & Wade, LLC. Her practice focuses on advising clients on aircraft purchase/sale contracts, and on the ownership and operational structuring of their private and corporate aircraft. She may be contacted at khague@jetlaw.com

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