



## Co-Ownership: Structuring the Agreement

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In a perfect world, money would be no object. All general aviation aircraft would be purchased for cash, none would be financed, and all would be wholly owned a single owner. Unfortunately, economic realities often don't allow sole ownership of an aircraft. Even if the Direct Operating Costs (DOCs) are manageable, significant fixed expenses such as the aircraft payment, hangar, insurance etc. are often too high for some to avoid the temptation to seek sharing among several co-owners. Irrespective of whether they use the aircraft exclusively for recreational purposes, co-ownership is serious business and should be set up and run like a business.

### **How should title be held?**

For United States Citizens or Permanent U.S. Residents, an individual owner could simply hold title of an N-numbered aircraft in their own name. For estate planning purposes, title would be held in their revocable trust to avoid probate in many states. Individual (or trust) ownership is fine if nobody else will ever fly your airplane, including post-maintenance of ferry flights.

However, if anyone else will be flying your aircraft, especially if two or more co-owners will frequently operate the aircraft, taking title as multiple, individual co-owners exposes each of them to every other pilots' negligent actions. For this reason, Limited Liability Companies (LLCs) are often used as a firewall between a member's personal assets and another pilot's liabilities. There is an FAA requirement that at least 75% of the members of an LLC must be United States citizens (not merely Permanent U.S. Residents). While an LLC will not protect anyone from personal liability from their own negligence as PIC, it will almost always limit the liability of the other non-PIC co-owners to their equity in the LLC (i.e., their equity in the aircraft).

A common LLC structure has a single LLC owning the aircraft, with the LLC's members all being individuals. If nobody is expensing the aircraft for business use, all member funds deposited into the LLC bank account are classified as "capital contributions" (not income) to avoid the filing of any federal income tax returns. If the LLC receives any income (such as rental to a member's business) this multi-member LLC usually requires the annual filing of an IRS Form 1065 partnership tax return.

However, if any of the co-owners want to depreciate the aircraft in any manner, a single LLC structure does not work. Since each co-owner will have a different percentage of business use and varying depreciation schedules (i.e., MACRS, Section 179, or soon to be phased out Bonus

depreciation), none of them want their business deductions to be dependent on the flying habits or tax returns of the other co-owners. In this scenario, each co-owner would own their share of the aircraft in a separate LLC, with the sole member of each LLC being either that individual or their business entity. Hypothetically, if there were three co-owners with unequal depreciation, the aircraft would be co-owned by LLC #1, LLC #2, and LLC #3 (all three of which would be on title with the FAA. Since each LLC is a single member LLC, each are disregarded entities for tax purposes, no “partnership” style entity exists, and no 1065 tax return need be filed. Note that the FAA does not recognize co-owner percentages, so in their eyes, it is up to them to enter into a separate agreement to clarify that relationship.

### **The Written Agreement**

Regardless of structure, anytime two or more co-owners (who are not already husband and wife) take title to an aircraft, there should be a professionally drafted co-ownership agreement that clearly identifies each co-owners’ rights and responsibilities toward each other and the aircraft. Without one, misunderstandings can turn the best of friends into the worst of enemies. Too often, co-owners wait to purchase an aircraft, and then start discussing the terms of the agreement. Too late! The time to start codifying the terms under which the co-owners will fund and maintain the aircraft’s operations is before the purchase. Sometimes, the starting this process early causes potential buyers to realize that their future co-owner isn’t really a good fit after all.

Common areas of co-ownership that need to be addressed are:

- 1) How will flights in the aircraft be scheduled? Can one co-owner fly anytime without limitation?
- 2) Where will the aircraft be based, and which co-owners can decide to change it?
- 3) How much are the flight hour contributions (for DOCs and reserves) and fixed monthly contributions?
- 4) If the above contributions are insufficient to keep the aircraft airworthy (or heaven forbid, make the aircraft payment), which co-owners will kick in additional short-term funding? Note: nearly every lender will require all co-owners (as individuals) to be guarantors on the LLC(s)’ loan.
- 5) Can pilots other than co-owners fly their aircraft? For how much per hour? What pilot qualifications are required?
- 6) If some co-owners are a lower insurance risk and others drive up the cost of insurance, should the premiums still be split equally or should the higher risk pilots pay a higher share?
- 7) How much can a co-owner spend on maintenance or repairs without the consent of the other co-owner(s)? Is this amount higher if the aircraft is AOG a thousand miles away?
- 8) Who can authorize (or demand) non-compulsory upgrades?
- 9) What happens when one or more co-owners want to sell? Do the others have a first right of refusal? Are there objective or subjective criteria (or both) for new co-owners?
- 10) What if two or more co-owners think the other is a questionable pilot or not honoring their agreement? Can they be forced to sell?
- 11) What happens when a co-owner dies, becomes insolvent, or gets a divorce? The last thing an aircraft owner wants is to have a former co-owner’s non-flying spouse, or creditors, as a new “partner”.

### **Future Ownership Changes**

When it comes time for one co-owner to sell, it usually does not result in the sale of the entire aircraft. In cases where a single LLC owns the aircraft and one of the co-owners wants out, they simply sell their membership interest in the LLC. There is no change of title with the FAA, but it does trigger the requirement to file an updated LLC Statement in Support to document the LLC's 75%+ citizenship requirement. If multiple LLCs are co-owners in the aircraft, and assuming that seller's LLC was a disregarded entity for income tax purposes, then the selling co-owner can simply sell their entire LLC to a buyer (new co-owner) and avoid the need for any FAA registration changes. Also, as a general rule, transfers of equitable ownership in legal entities does not trigger sales tax. If the aircraft's home airport does not change, equity transfers usually do not trigger additional use tax either.

As for aircraft that are financed, co-owners are at the mercy of their lender. In the case of an aircraft owned by a single LLC, the LLC is the borrower and each of the members are guarantors. Any change in membership usually triggers an acceleration clause in the promissory note, requiring a payoff to change members. Some lenders will allow for a substitution of members (and guarantors) if the proper requests are made in advance. However, when a lender finds out after the fact and consent was not obtained, don't be shocked with the LLC gets an unexpected payoff demand.

### **Who should draft these Agreements?**

As to co-ownership agreements, the author of this article is an aviation attorney, and would naturally suggest that the drafter be highly experienced with similar agreements. Non-aviation attorneys are a step in the right direction, but often don't know what questions to ask or what problems can arise. Even though AOPA has co-ownership "templates" on their website, AOPA still advises its members to use them in conjunction with legal counsel (not as a "fill in the blank" questionnaire).

In the case of the sale of an LLC (or a portion of an LLC's membership interest), aircraft brokers are out of their element to draft such agreements. Only an attorney should do so, and all parties should consult with their tax advisors.

### **Summary**

Aircraft co-ownership is not for everyone. Sometimes though, it is the only economically viable (or palatable) option for the ownership of that type aircraft. Ultimately, the prospective co-owners must decide for themselves how to hold title, and what the terms of their co-ownership agreement will be. Most importantly, these decisions should be made before any obligations are incurred that lead to the purchase of an aircraft.

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