



Aircraft LLCs and Illegal Charters: Should You Be Concerned?

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The original version of this article appeared in
both MMOPA and COPA Pilot Magazines, 2023



CIRRUS OWNERS &
PILOTS ASSOCIATION

Most of us have played the trivia game Two Truths and a Lie. For this article, I'll mix it up and present Two Lies and a Truth:

- 1) The FAA is cracking down on illegal charter operations;
- 2) Owning your aircraft in an LLC will constitute a "flight department company" and therefore an illegal charter operation; and
- 3) LLCs are really a waste and don't really provide any liability protection for the owner.

Instead of making you turn to page 128 of this magazine for the answer, let's make it easy: #1 is true and the others are false.

Why an LLC?

Owning an aircraft in an LLC is smart, primarily from a liability perspective. While it is true that an LLC will not shield the Pilot in Command from his or her own negligence while flying an aircraft, an LLC usually provides significant liability protection for members when others are flying the aircraft and for members who have subsequently sold their aircraft and are facing claims from subsequent owners. LLCs are separate legal entities from their members, just like corporations are separate legal entities from their shareholders. By statute, every state in the U.S. treats corporations and LLCs the same in shielding their shareholders or members from the liabilities of the entity. So long as the member does not: a) co-mingle LLC funds with personal funds, b) fail to maintain LLC formalities (i.e., annual registration, maintenance of good standing), or c) fail to fund the LLC to meet its contractual obligations, then its members are generally insulated from most LLC liabilities. Sure, lots of plaintiffs' lawyers love to brag about "piercing the LLC veil", but as a practical matter, very few are successful. LLCs were created by statute to protect their members from most liabilities, and that is exactly what most courts do when members are dragged into lawsuits against an LLC without a basis for individual member liability.

From a tax perspective, LLC which are owned by a single member (either a person or an entity) are considered disregarded entities for tax purposes. A single member LLC does not file any federal income tax return; all taxable activities flow directly to the member on that member's tax return. A husband and wife in a community property state can also be a single member, with that member being the marital community.

Multi-member LLCs are taxed as a partnership and file an IRS 1065 partnership return each year. The profit or loss of those LLCs are reported to the members each year on a K-1. For situations where two or more members will own an aircraft for personal use only, a single LLC with multiple members works fine. It also has the added benefit of making the sale of a member's share of an aircraft easier: the member simply sells their membership interest in the LLC to a new buyer and there is no change of title to the aircraft. Depending on the state, this can also reduce or eliminate sales tax on the transaction.

When two or more members want to purchase an aircraft together, and any of them wants to depreciate or expense their share of the aircraft for business purposes, a single LLC owning the aircraft really doesn't work well for tax purposes. The better structure here is for each aircraft co-owner to own their respective interests in the aircraft within their own single-member LLC (i.e., 3 separate LLCs each own 1/3 of the aircraft). This allows each co-owner to avoid any interdependence with other co-owners, eliminate messy K-1s, etc.

The 75% Rule for LLCs

LLCs that own N-numbered aircraft must have at least 75% of their members as U.S. Citizens (not merely U.S. Residents). If you cannot meet this rule due to lack of citizenship, then the only cost-effective option is a Non-Citizen Corporation. This must be a C-corp and has semi-annual flight reporting requirements to the FAA. Aircraft beneficial owner trusts are very expensive and are rarely used in the piston world due to costs.

Tax Deductions Depend on Use

Owning an aircraft in an LLC or corporation does not create, nor does it diminish, any tax deductions for aircraft ownership. Tax deductions for aircraft are based on the type and percentage of business use of the aircraft, and not whether it is or is not in a legal entity. W-2 earners will rarely be able to deduct aircraft expenses from their ordinary income. Also, most flight school leaseback is considered "passive", meaning those losses will not be able to offset ordinary income.

The Dry Lease

When an LLC (the following also applies to a non-citizen corporation) owns an aircraft, and if that LLC has no real business purpose other than aircraft ownership, the FAA considers the LLC a “flight department company”. If the LLC then provides both the aircraft and the pilot(s) in the carriage of passengers or cargo, this can be viewed by the FAA as an illegal charter operation. The simple solution is to have the LLC “Dry Lease” the aircraft to the Lessee (usually the LLC’s member), under which the Lessee has “Operational Control” of the aircraft. In the context of a Dry Lease, the term “dry” means without pilot services, and does not in any way reference who pays for the fuel. The hourly rate in the Dry Lease can be as low as \$0.00 per hour; the FAA really doesn’t care. All the FAA does care about is that the Lessee is in Operational Control of the aircraft, meaning that the Lessee generally decides where and when the aircraft takes off and lands. The Lessee in a Dry Lease can be the LLC member who flies the aircraft as PIC, or some other person or entity that hires its own professional pilot.

For large turbojet aircraft, a copy of the Dry Lease must be provided to the FSDO 48 hours prior to that Lessee’s first flight, a copy of the Dry Lease must be mailed to the FAA within 24 hours of signing, which also be carried onboard the aircraft. In the piston and SETP world, there is no requirement to notify the FSDO or mail the Dry Lease, but it is still recommended to keep a copy of the Dry Lease with you (even on an iPad) in case you ever have the good fortune to be ramp checked.

FAA Crackdown on Illegal Charters

OK, we did state that #1 was true, so what exactly is the FAA cracking down on? Rest assured, the FAA is not wasting their time investigating owners who put their aircraft in LLCs and then fly their own aircraft. I have yet to see a single FAA enforcement case under this scenario. What the FAA is concerned about are aircraft owners (whether LLCs or corporations or individuals) “holding out” their aircraft as being available to transport passengers or cargo. For example, an LLC cannot let it be known to the public that its aircraft is available for a lease, and then conveniently tell the Lessee that the LLC’s member will be the pilot. This is what the FAA calls a “sham lease” and will lead to enforcement. When the aircraft owner also tells the Lessee to pick from its preferred list of pilots, it also violates the single source rule. To stay in Part 91 and not stray into Part 135, the Lessee needs to procure the aircraft and the pilot(s) from independent sources. The only restriction on the Lessee’s pilot selection should be their qualifications for the aircraft’s insurance policy.

Further, aircraft owners can also raise the FAA’s eyebrows and can trigger an illegal charter investigation by either:

- a) Accepting more than a pro-rata share of the variable cost of that flight from passengers they fly with; or
- b) Violating the common purpose test (i.e., search for paying passengers with no common purpose to the pilot's mission).

There are many good publications to help keep aircraft owners compliant with regulations concerning Dry Leasing. They include:

[FAA Advisory Circular 91-37B](#)

[FAA Advisory Circular 61-142](#)

[General Aviation Dry Leasing Guide](#) (published by the FAA with the support of NBAA, AOPA, and others).

In sum, owning an aircraft in an LLC is perfectly legal and can offer some liability protection for owners. However, a simple Dry Lease and basic common sense can make the difference whether the FAA investigates you or some other owner.

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