

# HERR LAW FIRM

Fractional Jet Ownership  
Aviation

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## JET OPTIONS

### CHARTER

1. The cheapest option since charter rates do not cover the full cost of ownership.
2. Age and quality of aircraft varies, as does the quality of the operators.
3. Availability is not guaranteed.

### TIME CARDS

1. Credit risk due to pre-purchase.
2. Best suited for low usage or intermittent usage.
3. May be issued by charter operators – need to vet quality.
  - a. Sentient preferred light cabin \$4750/hr; mid \$6700; super-mid \$9525; large \$12,575.
4. May be issued by fractional programs – very expensive, but higher quality with a more consistent product.
5. Flexjet LR45 \$7,836/hr; LR60 \$8,674; C300 \$11,777; C604 \$13,550.

### WHOLE OWNERSHIP

1. Expense can be reasonable with high utilization.
2. Expense is exorbitant with low utilization.
3. May operate with internal flight department, or outsource to an aircraft management company. Management company may be able to increase utilization by chartering.

### FRACTIONAL OWNERSHIP

1. Less expensive than an under-utilized whole aircraft or a fractional card.
2. Most consistent product: age limit on aircraft, aircraft are equipped and painted the same way, pilots wear the same uniforms and undergo the same training.
3. Most convenient: guaranteed availability with minimal advance notice.

### OWNERSHIP STRUCTURE (whole & fractional)

1. Liability exposure for charter and time cards is relatively limited, except for Marquis where customer is a lessee.
2. The desire for liability protection leads many astray – causing them to segregate the aircraft ownership and operation in a separate company, i.e. a company with no assets or operations other than the airplane. Unless that company is an air carrier with a charter certificate, segregation is a violation of FAR 91.501 – which requires that aircraft operations be incidental to the non-aviation operating business.
3. Without a charter certificate, reimbursement is generally prohibited. Owners should not accept reimbursement from friends who use the plane; companies should not accept reimbursement from employees who use the plane.
4. Fractional owners may not accept reimbursement from friends even if the fractional program has an air carrier certificate.
5. SOLUTIONS:
  - a. Operate safely – the FAA intends liability to be a safety incentive.
  - b. Buy high limits of insurance.
  - c. Create a sales-marketing-travel subsidiary with incidental aircraft operations.



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- d. Legally segregate the aircraft by getting a charter certificate or by placing with a management company with a charter certificate (all payments subject to 7.5% FET). For tax purposes, group with the operating business so that aircraft losses can offset business income (Rev Proc 2010-13 requires filing of grouping statement); avoid passive losses.

## FRACTIONAL OVERVIEW

1. Acquisition: Can buy interests as small as 1/32 (25 hours per year) and can scale up from there: 1/16 is 50 hrs/yr; 1/8 is 100 hrs/yr.
  - a. 1/16 shares (used): Citation Encore \$375k; Hawker 900XP \$500k, Challenger 300 \$1.125M; Gulfstream 450 \$1.875M; and Gulfstream 550 \$2.5M.
2. Operating costs are generally a fixed monthly amount plus an hourly amount for any flight activity. Cash operating costs per hour, including fuel surcharge, are:
  - a. Encore \$5,000; Hawker 900XP \$6,300; Challenger 300 \$7,700; Gulfstream 450 \$11,400; Gulfstream 550 \$12,100.
3. Flexibility: can buy 1/8 of a Hawker and 1/16 of a G450.
  - a. After acquisition, many programs allow for downgrades to smaller aircraft, and upgrades to larger aircraft (if available). Interchange ratios apply for billing.
  - b. Use of multiple aircraft per day: depending on share size, may be entitled to multiple aircraft per day.

## STATE OF THE FRACTIONAL INDUSTRY

1. High-growth days are over. During the boom, programs made money on sales of new aircraft at list price (purchased from manufacturers at a fleet discount). Owners were happy with high residual values.
2. New aircraft shares were the best value during the boom: programs sold at list price without a market premium.
3. Downturn has caused a new focus on operations. Operational losses have led to:
  - a. increased operating costs (monthly and hourly); and
  - b. increased operational restrictions: notice time, peak days, multiple use.
4. Used aircraft are currently the best value, G550 least attractive, fleet models most attractive: 400XPs, 800XPs, Citation Xs.

## TAX

1. Purchases
  - a. Sales tax is easy to avoid.
  - b. Use tax may be hard to avoid
    - i. Qualify for exemption based on weight or usage.
    - ii. Structure as a lease – in some states.
    - iii. NY advisory opinion on Gap fractional share.
2. Like-kind exchanges
  - a. Apply to fractional shares with the standard timing rules and need for a qualified intermediary.



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## 3. FEDERAL EXCISE TAX

- a. 7.5% plus segment fees apply to commercial operations (payment or reimbursement for aircraft and crew) – does not have to be a charter for FET to apply.
- b. If owner violates FAR 91.501 by accepting reimbursement, FET is due.
- c. If management company has command, possession and control, FET is due for owner's flights.

## PERSONAL USE OF BUSINESS AIRCRAFT

1. Subsequent to the Jobs Act of 2004, personal use is much more complicated and much less tax-efficient.
2. Use must be categorized at least three ways: i) business, ii) personal non-entertainment, and iii) personal entertainment. Business and personal non-entertainment uses are deductible, but personal entertainment use is non-deductible (operating, fixed, and depreciation) except to the extent that income is imputed to employees.
3. Annual % that is non-deductible may be calculated based on seat hours, seat miles, or flight hours.
  - a. Disallowed depreciation should be kept in a suspense account and can offset recapture.
4. Employees should be imputed SIFL (standard industry fare level) income for personal use. Employees may not reimburse the company (FAR 91.501).
5. SEC disclosure: aggregate incremental cost.
6. To minimize deduction limits: segregate entertainment use to a low-basis aircraft (use like-kind exchange) and a low-cost aircraft (perhaps jetcard or fractional share).
7. Since company is paying for entertainment use with after-tax dollars, it may be preferable to have employees own fractional shares for their use. This also avoids SEC disclosure.
8. Record keeping is critical to distinguish personal non-entertainment use. Audit risk is high.

## INSURANCE

1. Higher liability exposure for fractional aircraft or aircraft on a charter certificate: higher usage, fewer passengers subject to workers' comp. U.S. airline fatalities average \$7-8M per passenger.
2. For aircraft with a management company, or fractional aircraft, insurance normally procured by the manager. Policy needs to be tailored to owner, not just manager:
  - a. Owner should be loss payee for hull proceeds.
  - b. Owner should have Breach of Warranty endorsement, so that acts of manager that void the insurance policy do not void coverage for owner.
  - c. Owner should have waiver of subrogation to be protected for hull damage while using other aircraft in the fleet.
  - d. Notice of cancellation should be sent to owner –and not at manager's address.

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