

The American Paradise: Using a Tax Free U.S. Virgin Islands Exempt Company for FAA Registrating of Foreign-Owned Aircraft - Law Firm Solomon Blum Heymann LLP Attorneys New York, New York

THE AMERICAN PARADISE: USING A TAX-FREE U.S. VIRGIN ISLANDS EXEMPT COMPANY FOR FAA REGISTRATION OF FOREIGN-OWNED AIRCRAFT

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Practitioners often focus on the voting trust when they create an ownership structure for a foreign client who is seeking Federal Aviation Administration ("FAA") registration of an aircraft. When the stock of a corporation formed in the United States is held by a voting trustee who is a U.S. citizen, the foreign owner of the corporation can be transformed into a "United States citizen" for purposes of FAA registration. This focus on the voting trust, and the requirement that the president and two-thirds of the board of directors and other managing officers of the corporation be U.S. citizens, is understandable because it leads to eligibility for the prized FAA "N" number.

The Federal Aviation Act of 1958, as amended, and its corresponding regulations devote several sections to the citizenship requirement and the voting trust. However, requirements for the place of incorporation of owner receive scant attention in the law's definitions. In brief, the corporation need only be "organized under the laws of the United States or of any State, Territory or possession of the United States."

To Tax or Not To Tax?

A Delaware corporation often is selected as the entity to own the aircraft. Delaware is often the jurisdiction of choice for this purpose for the same reason that it is used by many of the country's largest corporations as well as hundreds of thousands of smaller ones: Delaware provides maximum corporate flexibility at minimum cost. Other states, too, can provide similar benefits. A corporation formed in any of the "states," however, except for one, will be subject to federal income tax at the usual corporate rates.

The one exception is not a state at all, except for purposes of the Federal Aviation Act; it is the unincorporated territory of the United States Virgin Islands -- a group of small islands in the Caribbean about 50 miles east of Puerto Rico and 1500 miles southeast of New York City. In cases where the aircraft will be used outside the United States, the use of a U.S. Virgin Islands exempt company as the aircraft owning entity offers two major benefits: FAA registration and 100 percent exemption from Federal, state, and local income taxes. If the aircraft is used partially within the United States, then the tax exemption applies only to the portion of the company's income which is from non-U.S. sources.

U.S. Virgin Islands exempt companies were authorized by the U.S. Congress in the Tax Reform Act of 1986. Unlike a corporation formed in Delaware or one of the other forty-nine states, a U.S. Virgin Islands exempt company is not subject to any Federal or U.S. Virgin Islands income taxes on income derived from sources outside of the United States. Similarly, there is no capital gains tax liability if an aircraft owned by a U.S. Virgin Islands exempt company is sold at a profit.

Ownership Requirements

The voting trust structure is usually established by means of a transfer by the foreign shareholder to an independent voting trustee of the right to exercise at least 75 percent of the corporation's voting power. When such a structure is used, in addition to the usual bill of sale and registration application, the owner must submit to the FAA a copy of the executed voting trust agreement and an affidavit of the voting trustee representing that the trustee is a U.S. citizen and not related to the beneficial foreign owner in such a manner that the owner could influence the trustee's judgment. The trust itself must stipulate that the trustee and any successor trustee are to be free from the control of the foreign owner. It must also provide that the process by which any successor trustee is appointed will ensure the same result.

There are several requirements to qualify as a U.S. Virgin Islands exempt company, the most important of which concern ownership. Under the Internal Revenue Code, U.S. persons (generally defined as individuals who reside in the fifty states and the District of Columbia and entities established in one of those jurisdictions) must own less than 10 percent of the total voting power and total value of the stock of an exempt company. In addition, under local U.S. Virgin Islands law, U.S. Virgin Islands persons must own less than ten percent of the total voting power or total value of the company's stock. Therefore, a U.S. citizen who resides in the U.S. Virgin Islands and who does not own any beneficial interest in the exempt company's stock can serve as the voting trustee. Typically, this will be a local attorney or the employee of a management or trust company. A trustee with these qualifications will not only meet the exempt company ownership requirements of U.S. Virgin Islands law but also will meet the ownership requirements of the Internal Revenue Code because, as a U.S. Virgin Islands resident, the trustee will not be treated as a United States person. Finally, as confirmed in a letter from the Assistant Chief Counsel of the FAA (copies of which may be obtained from the authors of this article), the company will meet the ownership and control portion of the U.S. citizenship requirements of the Federal Aviation Act because the trustee meets the act's definition of a United States citizen, which does not depend on the trustee's residence.

Other Corporate Details and Structural Considerations

To qualify for tax benefits, in addition to meeting the ownership requirements, a U.S. Virgin Islands exempt company must be incorporated in the U.S. Virgin Islands and must elect to be treated as an exempt company. The election may be contained in its articles of incorporation or it may be in a separate

statement that accompanies the articles. An exempt company must have at least three directors and it must appoint an agent for service of process in the U.S. Virgin Islands. It must also have at least the following officers: president, secretary, and treasurer. The corporation's annual meetings may be held outside the U.S. Virgin Islands and written consents can be used in lieu of any meetings.

One additional U.S. Virgin Islands requirement is that an exempt company cannot engage in the active conduct of a trade or business in either the United States or the U.S. Virgin Islands. This requirement should not create any problems in cases where the aircraft is to be operated exclusively overseas. In cases where an aircraft will sometimes makes flights into and out of the United States, the exempt company's activities in the United States can generally be structured to meet this requirement. The only other requirement is that the president and two-thirds of the board of directors and managing officers be U.S. citizens, as discussed above, but they may reside anywhere in the world.

Federal and U.S. Virgin Islands Tax Benefits

A U.S. Virgin Islands exempt company used exclusively overseas is exempt from all U.S. and U.S. Virgin Islands taxes, including income, capital gains, and withholding taxes, except for the annual U.S. Virgin Islands corporate franchise tax of \$1,000.

An exempt company established for the ownership of aircraft is not required to obtain a U.S. Virgin Islands business license. In addition, the company may obtain a 20-year contract from the U.S. Virgin Islands Government guaranteeing that its tax benefits will not be reduced. Finally, unless an exempt company earns income from sources within the United States or the U.S. Virgin Islands, it is not required to file an income tax return with either the U.S. Virgin Islands tax authorities or the IRS.

Confidentiality of Records

Unlike entities established in tax haven jurisdictions that do not have information exchange agreements with the United States, the U.S. Virgin Islands offers confidentiality, but not secrecy, for shareholders of U.S. Virgin Islands exempt companies. The identities of shareholders can be revealed to U.S. or U.S. Virgin Islands tax authorities upon their proper request, but this information is not available to the general public.

Only very limited information regarding a U.S. Virgin Islands exempt company is available for public review, including the company's name and mailing address, the names and addresses of its directors and officers, and the date of its fiscal year end. This information is contained in an annual report, which must be filed in the Office of the Lieutenant Governor by June 30 of each year. Additionally, an exempt company's articles of incorporation are available for public inspection.

Redomiciliation of Foreign Corporations to the U.S. Virgin Islands

An existing foreign company that already owns an aircraft and that seeks to register it with the FAA may find it convenient to take advantage of the U.S. Virgin Islands' redomiciliation statute. This provision permits the company to assume U.S. Virgin Islands exempt company status without reincorporating and transferring ownership of the aircraft. Under the redomiciliation statute, which was modeled on the Delaware statute, a foreign corporation may transfer its domicile to the U.S. Virgin Islands by filing a certificate of domestication along with a certified copy of its articles of incorporation with the Office of the Lieutenant Governor. The certificate of domestication must include the date when and the jurisdiction where the corporation was first formed or incorporated; the name of the corporation prior to filing the certificate of domestication in the U.S. Virgin Islands; and the jurisdiction that constituted the seat, principal place of business, or central administration of the corporation prior to filing the certificate.

Upon filing of the certificate of domestication and the articles of incorporation, the corporation is continued in the U.S. Virgin Islands and its domicile is considered to be in the U.S. Virgin Islands. From that time forward, the laws of the U.S. Virgin Islands apply to the corporation just as if it had been incorporated in the U.S. Virgin Islands on the date when it was first formed, incorporated, or otherwise established in another country or jurisdiction. However, the domestication of any corporation in the U.S. Virgin Islands does not affect any prior obligations or liabilities.

A foreign corporation that changes its domicile to the U.S. Virgin Islands can elect exempt company status by including a statement in its certificate of domestication that it will be considered to be a U.S. Virgin Islands exempt company once the domestication is in effect. A permanent redomiciliation costs \$500 for a corporation that elects U.S. Virgin Islands exempt company status. In addition, the corporation will thereafter be subject to the annual \$1,000 franchise tax that all U.S. Virgin Islands exempt companies must pay.

In brief, a U.S. Virgin Islands exempt company should be considered seriously by any foreign person who desires to hold an aircraft in a U.S. flag entity that will qualify as a "U.S. citizen" for FAA registration purposes, and who wants to avoid U.S. income tax payment and filing requirements.