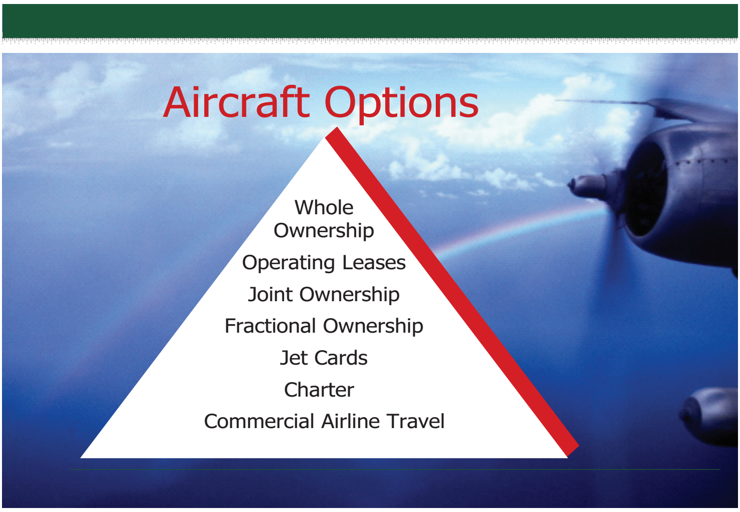
Primer on Private *Jet* Travel

By Gregory P. Cirillo and Gary I. Horowitz

Introduction

Modern private jets cannot be surpassed when it comes to travel with a real measure of comfort, privacy, productivity, "class" and dignity, and this is why private aviation continues to broaden in new ways and become more accessible to the public.

The benefits of flying on a private aircraft are numerous: it saves time; there is flexibility in scheduling the departure time, departure location and destination; passengers can avoid long security lines; special terminal access and luggage handling are provided; and passengers have in-flight privacy. Today, there are a wide array of aircraft ownership and use options that allow more travelers to pick the combination of aircraft, flight-time access and cost that is right for them.



Commercial Airline Travel

Commercial airlines are not part of private aviation, but worth mentioning at the outset for purposes of contrast and setting a baseline. Commercial aviation and private aviation are two completely different business models that are very difficult to compare. Commercial aviation is generally designed to move large numbers of people to common locations on a scheduled route—cost being the primary consideration. With private aviation, cost is certainly an important factor, but other considerations, such as saving time and having more privacy and comfort, can be equally or more important. The economics of commercial aviation are driven by economies of scale and scheduled service. A typical commercial aircraft may burn more fuel than even a larger private jet, but it: (1) carries many more passengers, (2) often operates 10 times the number of flight hours over a given period of time and (3) operates 80% full on every flight. As a result, it is virtually impossible for a private aircraft to defeat the pure economics of commercial air travel.

Charter

Traditional, on-demand charter of a private aircraft is the lowest level of commitment to private jet usage, and as a result, it can have the most expensive per seat-mile. Chartering an aircraft is structurally the same as renting a limousine. Each flight is a completely separate transaction that needs to be independently negotiated. Firms that offer charter services are required to hold a certificate issued by the Federal Aviation Administration (FAA) called a "Part 135" certificate. To obtain and retain such a certificate, the provider must maintain specific operating procedures and manuals, and have several key staff members that meet regulatory standards for safety and maintenance. Although there are a few web-based services that attempt to streamline the process, most charters are booked through brokers who seek bids from aircraft operators.

Pros:
Relatively easy to arrange and schedule a charter flight
Flight costs are fixed at an hourly rate with surcharges
Choice of aircraft, depth of fleet
Choice of departure time, departure location and destination
Limited liability - charter company has "operational control" of the aircraft
Compared to other private flight options, generally the lowest total cost option (no aircraft ownership, so no large capital costs)

Cons:
Highest unit-cost for private jet travel
Less than 100% reliability (charter can be cancelled before the flight)
Costs generally include charges for repositioning, "deadhead" flights, overnight waiting, fuel, catering, etc.
Pricing changes with each flight
No guarantees on specific aircraft availability
Aircraft safety and maintenance quality can vary
Federal excise taxes

Jet Cards

Jet cards (also called flight cards or charter cards) are essentially pre-paid charter flights. Depending upon the card, you can purchase a specific number of hours (*e.g.*, 25 or 50) on a particular aircraft class, or deposit a dollar amount ($50,000) with a jet card operator, which will then debit your jet card for each trip at the current hourly charter rate for the aircraft. Jet card programs vary significantly. Some jet card programs are just debit cards, while other jet card programs offer guaranteed aircraft availability with limited notice (4 to 12 hours), guaranteed rates and standard catering.

Pros:
Same as charter
Simplicity
Could be lower cost than charter (but not a certainty)
Can have multiple flights on different aircraft simultaneously (multiple users)

Cons:
For debit-style cards, you lose the time-value of your money
You are locked into a specific provider for the balance of the card
Potentially inferior service to fractional/joint/ whole ownership
Same disadvantages as fractional ownership
Federal excise taxes

Fractional Ownership

Fractional ownership emerged in the 1990s as an effort to put more users into private aircraft by selling an aircraft in virtual slices. Such programs were legally structured as a hybrid of existing FAA regulations permitting multiple owners/users and permitting owners to swap aircraft. It was subsequently given its own regulatory standard as a subset of private aircraft ownership known as Part 91, Subpart K. Although the fractional regulations are written into "Part 91", which governs private, non-charter aircraft use, the Subpart K regulations require the fractional program to meet many of the standards applicable to Part 135 charter operators.

Fractional programs opened the market to owners that had a need (or want) for their own aircraft, but lacked sufficient need (or want) to justify full ownership. In a fractional ownership program, you buy "shares" of an aircraft in increments, the smallest fractional share being 1/16th. Each 1/16th share generally guarantees you 50 hours of flight time each year. The aircraft is managed, maintained and flown by the fractional program.

Pros:	Cons:
✈ Fractional programs are "turnkey" operations – owners have minimal burdens for scheduling flights and flight activity	✈ Purchase price for 1/16 of an aircraft includes a premium for the fractional program (the sum of the parts is greater than the whole)
✈ Aircraft are professionally managed and maintained	✈ Higher relative cost of management and operations than joint/whole aircraft ownership
✈ Lower entry costs compared to joint/whole aircraft ownership	✈ Aircraft buyback usually at lower value
✈ Guaranteed availability of your aircraft or another aircraft in the fleet	✈ Five year commitment
✈ Guaranteed buyback at fair market value (less a remarketing fee)	✈ Different pilots from flight to flight
✈ Some options to exit early or have shares re-marketed	✈ Older aircraft
✈ Tax benefits of ownership (e.g., depreciation)	✈ Federal excise taxes
✈ Flexibility - you can buy multiple shares in the same aircraft, or multiple shares in difference aircraft (by class and type)	✈ Liability and publicity of aircraft ownership

Joint Ownership

Prior to the advent of fractional ownership, owners wishing to share the cost of aircraft ownership could, under FAA regulations, come together as joint owners. This method of shared ownership continues today. Two or more persons or companies can own an aircraft in a "joint ownership" arrangement whereby all of the costs of purchasing, operating and maintaining the aircraft are shared. This works well when several people or businesses need substantial flight hours each year (*e.g.,* 150+ hours per year), but do not need enough flight hours to justify purchasing a whole aircraft (generally considered to be more than 300 hours per year).

Pros:	Cons:
✈ Aircraft availability	✈ You have partners – need to work out aircraft scheduling system, aircraft use, dispute resolution, aircraft disposition
✈ Hand-picked pilots dedicated to your aircraft	✈ Sharing aircraft will dilute availability
✈ Ability to generate revenue by chartering the aircraft to 3rd parties	✈ Difficult to withdraw
✈ Potential tax benefits (depreciation, sales/use tax)	✈ Substantial financial investment (compared to charter/jet card/fractional)
✈ Potential (although rare) appreciation in value of the aircraft	✈ Responsible for maintenance and repairs
✈ FAR Part 91 operations (less burdensome/costly than Part 135 for charter)	✈ Liability and publicity of aircraft ownership

Operating Leases / Finance Leases

Instead of owning the aircraft, you arrange for a lender to purchase the aircraft and then lease it to you for a term of years (*e.g.*, 2 to 7 years). In an "operating lease" or "true lease" the owner/lessor of the aircraft expects to take the aircraft back at the end of the lease. In a "finance lease," you are committed (and highly incentivized) to purchase the aircraft at the end of the lease, and lease payments "amortize" the purchase price.

Pros:	Cons:
✈ Lower initial capital costs	✈ Not financially viable for low flight-time users
✈ Aircraft availability	✈ Deadhead and idle time costs
✈ Hand-pick pilots dedicated to your aircraft	✈ One aircraft only
✈ Ability to generate revenue by chartering the aircraft to third parties	✈ Management obligations
✈ Flight operations under less burdensome FAR Part 91	✈ Responsible for maintenance and repairs
✈ Transfer risk of economic depreciation to lessor/lender (except in a finance lease)	✈ Liability for flight operations
✈ Potential appreciation under aircraft buy-out option (if there is one)	✈ Sales tax on lease payments
✈ Discounted capital cost because lender/lessor receives tax depreciation	
✈ Aircraft does not appear on lessee's balance sheet	

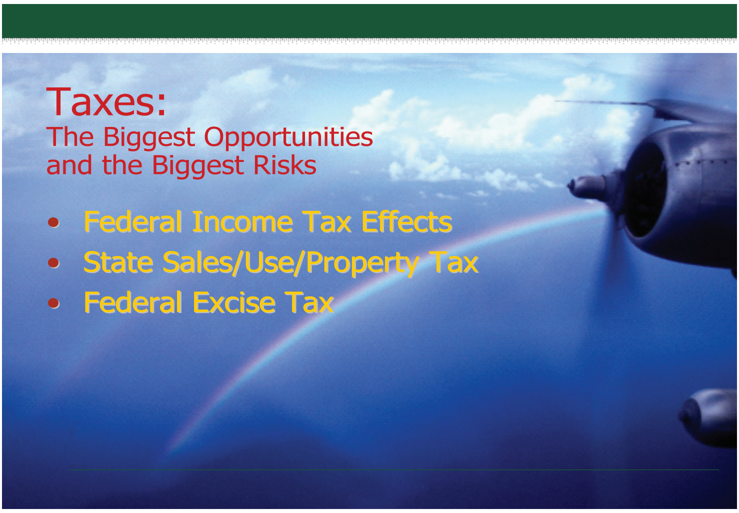
Whole Ownership

Buying and owning the entire aircraft is "whole ownership." The major advantage of whole aircraft ownership is total control and flexibility over all factors relating to your air transportation, including availability, safety, security and comfort.

Pros:	Cons:
✈ Aircraft availability	✈ Substantial costs – both initial capital outlay and annual expenses
✈ Hand-pick pilots dedicated to your aircraft	✈ Not financially viable for low flight-time users
✈ Ability to raise revenue by chartering the aircraft to 3rd parties	✈ Deadhead and idle time costs
✈ Potential tax benefits (depreciations, sales/use tax)	✈ One aircraft only
✈ Potential appreciation in value of the aircraft	✈ Management obligations
✈ Total knowledge of aircraft age and maintenance history	✈ Responsible for maintenance and repairs
✈ FAR Part 91 operations (less burdensome/costly than Part 135 for charter)	✈ Liability for flight operations
	✈ Risk of economic depreciation on aircraft

Taxes

Unfortunately, no primer on private jet travel options would be complete without mentioning taxes, which represent both opportunities and risks for private aircraft users. A comprehensive tax analysis and tax strategy is an essential part of any decision to buy or lease a private aircraft.



On the positive side, if a private aircraft is being used for business purposes, there are significant tax deduction opportunities (in particular, tax depreciation deductions) that can substantially reduce the effective cost of aircraft ownership. When aircraft use is a mix of business and personal, the ability to deduct costs becomes more complex, and requires that owners follow Internal Revenue Service (IRS) guidelines on apportionment of use and disallowance of tax deductions. In a corporate setting, the IRS also expects executives to treat certain personal uses of the aircraft as income.

Serious tax hurdles can also accompany private aircraft ownership and use, including state sales tax, use tax and personal property tax, along with special federal excise taxes that can apply to private air transportation services. The states have aggressive programs to identify aircraft that are either purchased in their state, or based there, and hit them with a sales or use tax (often 6%). There are a multitude of strategies available to mitigate these taxes, but most of them require pre-planning and structuring before the transaction occurs.

Lastly, and significantly, aircraft can qualify for tax-deferred exchanges under § 1031 of the Internal Revenue Code. This allows you to sell an aircraft (including a fractional interest) and roll the proceeds into a replacement aircraft, without recognizing taxable gain on the sold aircraft. Taxable gain is generally the sales price less the depreciated basis in the aircraft. In any regard, an aviation tax expert needs to be consulted before taking action.

Conclusion

Ultimately, choosing the right private jet travel option, or combination of options, has to be decided on a case by case basis. In making this decision, there are a number of questions to ask regarding scheduling needs; flight profile; lifestyle and personal preferences; financial, legal and tax considerations; and special requirements, but the number one question is: **How many flight hours do you need each year?** The answer to this one question will quickly point you towards the right private jet travel decision. ■

Contact Us

If you have any questions or would like more information on private jet ownership, please contact:

Gregory P. Cirillo
301-800-0001
gcirillo@hchlegal.com

Gary I. Horowitz
301-800-0001
ghorowitz@hchlegal.com

If you'd like to subscribe to HCH Legal's newsletter, *Airworthy: Insights into Current Aviation Legal Issues,* email gcirillo@hchlegal.com

HCH Legal, LLC

6400 Goldsboro Road

Suite 215

Bethesda, MD 20817

301-800-0001

www.hchlegal.com