7 WAYS TO FEND OFF THE BEAN COUNTERS

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these ideas can cut flight department costs and help you weather a tough economy_by Gregory P. Cirillo and Gary I. Horowitz

REVENUES ARE DOWN, the financial future is foggy and the bean counters are glaring at the line items associated with your corporate aircraft. Fending off the accountants can be tough, but it's certainly worth the effort because of the time saving, privacy, flexibility and security that business jets provide.

Here are seven strategies that can deliver significant savings:

1. Buddy up

Sharing the financial burdens of aircraft ownership and operation is a particularly viable option if you already share hangar space with other operators who are facing the same pressure to reduce expenses.

In considering aircraft sharing, keep in mind that the FAA and Department of Transportation don't allow a private (Part 91) aircraft operator to receive compensation for making its aircraft and crew available for third-party use. That arrangement would be a charter that requires you to hold a Part 135 certificate. Even if you had the necessary personnel and operating manuals, it could take two years to get the certificate. Fortunately, other options exist.

One is *managed charter*. If your aircraft meets Part 135 requirements already, you can easily add it to a Part 135 operator's charter fleet. If there's such an operator on your airport or on one close by, so much the better. The Part 135 operator would make the aircraft available to charter customers and share the revenues with you. This would allow you to recoup some of your costs, but as you might expect, the Part 135 operator will take a cut of the charter revenue, as will federal excise taxes. The managed charter option may be the easiest to implement, but it has a relatively low overall return.

Joint ownership is another possibility. Two or more people can own an aircraft together, since the FAA recognizes joint ownership and registration. This could reduce your capital investment and fixed costs by half or more. Joint ownership requires a supporting agreement specifying the rights and obligations of each owner. It should cover governance of operations, allocation of fixed and variable costs and contingencies, and the process for selling the aircraft or interests in it. Going from sole to joint ownership requires tax planning. In addition to sales taxes that could be triggered, the selling party may need to recognize taxable gain over a depreciated basis.

Aircraft buyers often create a special-purpose entity to own it, with that entity being owned by the aircraft's users. This is a conventional transaction–but it would run afoul of FAA regulations unless it includes dry leases to the users. The agency frowns on "shell" entities that exist solely to own and operate aircraft. Such entities look and act like airline or charter operators, but without the regulatory safeguards. Worse, the IRS could find that an aircraft-owning entity is providing transportation services, and claim that federal excise taxes apply to payments to that entity.

You can remedy these concerns by *dry leasing* the aircraft (a lease without a crew) to each of the entity's owners in exchange for rent and other payments. [You may also dry lease an aircraft to nonowning third parties under Part 91 (*see 2. below*), even though, as mentioned before, you may not charter to them unless you have a Part 135 certificate.–Ed.] In a dry lease, operational control over the aircraft is in the hands of the lessee. By transferring operational control to the lessee, you avoid the FAA classifying you as an illegal charter and you aren't providing transportation services that the IRS would call taxable. You can dry lease the aircraft on an exclusive basis (giving the lessee full and sole use of it), or if you wish to retain usage rights, you can enter into a nonexclusive dry lease reserving the right of the owner (or another lessee) to use the aircraft. The economics and other lease terms are open to extensive negotiation between the owner and the lessee.

It's worth noting that fractional aircraft ownership is accomplished through a multiple, nonexclusive-use structure, with each fractional shareholder assuming operational control for its use of the aircraft, so the general concept of shared use is well tested and accepted.

Interchange agreements offer yet another way to share. The FAA allows two airplane operators to swap use with each other by exchanging hours on their aircraft. If documented properly, this is a lawful way for two or more companies to make better use of multiple aircraft. This is particularly valuable when hangar neighbors have different aircraft types, allowing them to choose one that's best suited for each mission.

2. Lease out your aircraft

In certain segments of the market, buyers are waiting one to three years for delivery of a new business aircraft. This presents an opportunity for an aircraft owner willing to surrender full possession for that long. You could do this with a short-term dry lease or with a sale subject to an option or obligation to buy back the aircraft at a future date. Each of these options will improve cash flow, but with varying effects on financial statements.

3. Make some phone calls

If a 10-percent drop in costs would be enough to save your aircraft operations from the bean counters, then it's well worth asking for that level of price reduction from your suppliers, vendors and service providers. Your FBO, management company, insurance company, hangar lessor and even flight crew will likely prefer to preserve their positions at a modest discount, rather than lose them entirely. Any approach of this sort would need to follow a careful review of existing contractual provisions that might negatively or positively affect your bargaining position.

You may also find that you can obtain competitive bids for services that were previously purchased without comparative analysis, with predictable savings. Corporate flight departments are often under the umbrella of corporate services (the people who keep executives happy by arranging transportation, lodging and entertainment), where perfection is the goal, and competitive bidding is not a standard procedure. Now may be the time to focus on price as well as quality.

When contracting for services, consider using "credit kickers" in the form of credits against future parts and services, including pilot and mechanic training credits, and discounts on scheduled maintenance events. This can be a bit of a win-win outcome since the credits are worth more to the aircraft owner than they cost the provider. One final thought: What security deposits may be out there that you can have released or reduced?

MONEY-SAVING TIP

Going from ownership to a lease could improve your financial statements.

4. Refinance or restructure

If you currently own an aircraft (with or without financing), you should consider the benefits of restructuring into an operating lease or finance lease. Going from ownership to a lease could also improve your financial statements by moving the aircraft off your corporate balance sheet. Assuming you have solid credit, going from ownership to a sale and lease-back should be a routine transaction; and you may even be able to do it with your current financing bank.

Although we find ourselves in a financial downturn, the values of many corporate jets are at all-time highs. This presents the rare opportunity to refinance or engage in a sale-lease-back of the aircraft, and even take cash out to support future operations.

Keep in mind that any change in ownership structure could have substantial tax consequences. You could trigger sales taxes, depreciation recapture and loss of prior depreciation deductions, so bring your tax advisers into the process.

5. Tweak your taxes

Institute a self-audit of prior practices on any federal excise taxes you've paid and income tax deductions you've taken. Often, corporations overpay federal excise taxes by erroneously including nontransportation charges in the federal excise tax calculation (which should only include charges for transportation services). Also, there are several methods to calculate tax deductions and disallowances, so recalculations can yield better results. After the self-audit, if the numbers look materially better, you can file amended tax returns going back as much as three years.

Work with your aviation tax advisor to adjust your use and recordkeeping to maximize tax deductions (for example, impute income to executives using the aircraft for personal purposes at charter value rates instead of the lower "SIFL" rates) and minimize tax deduction disallowances for personal, entertainment use of the business aircraft. Reviewing past tax practices and adjusting current tax methods could result in a sizeable windfall with no downside and no change in operations.

6. Change your position

If a new-aircraft delivery looms on your horizon, you may be able to buy time or escape the upcoming burden of

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progress payments and ultimate purchase. The starting point is a review of the purchase agreement. Can you assign the contract to another buyer? We have yet to see an anti-assignment clause that didn't leave some wiggle room. If the agreement strictly forbids assignment of the position, you may want to assess the cost of terminating the deal.

You can work with the aircraft manufacturer to shift your delivery position and possibly achieve a win-win outcome. Perhaps another buyer is eager to obtain an earlier delivery date, in which case the manufacturer might be willing to push yours back. It might also be possible for you to take delivery of the aircraft and then immediately lease it back to the manufacturer to use for a time as a demonstration model, which would raise revenue for you on the lease and defer your ownership costs.

7. Downsize

Examine your flight requirements (seats occupied and distance) and see whether you can achieve savings by reducing the size of your fleet or trading down to smaller models. Identify your "sweet spot" or most common need–for example, four passengers going 500 miles–and adjust to that sweet spot. You can fill in the gaps (longer trips or more passengers) using charter, fractional interests or interchange as described above. Owning and operating more or larger aircraft than you require results in substantial unnecessary expense. As noted above, though, you should consider potential tax consequences of any ownership change.

Any of these strategies may be able to help you reduce aircraft ownership and operating costs without completely closing shop. At a minimum, these ideas will provide short-term relief and buy you time until conditions improve. ■

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