The George Costanza Rule of Private Aircraft Ownership: Are LLCs As Useful As They Seem?

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This is the story of four friends — Jerry, George, Elaine and Kramer — all of whom are successful and love to complain about the inconvenience of commercial airline travel. One day, George had an idea: "Remember that time we flew on a corporate jet and almost crashed when Kramer jumped up and down trying to get the water out of his ears? That was fun. We should pool together our money and buy our own private jet to share." Great idea, the gang agrees, except that Jerry, of course, is concerned about personal liability. "No problem," George says. "We'll just put the aircraft into a limited liability company, the LLC can hire a pilot to fly the jet, and whenever we want to fly we'll each just contribute money to the LLC to cover the costs." Sounds logical, right? Perhaps you've been there yourself. After all, the LLC is one of the most popular forms of private aircraft ownership, used by thousands of individuals to protect themselves and their estates from the considerable potential legal liability involved in owning and operating a private plane. But you and George are forgetting his golden rule: Anytime something makes this much sense, do the opposite!

That's because the LLC — seemingly a clever, convenient way to organize your plane's finances and shield your other assets from liability — can be an FAA and liability-insurance nightmare waiting to happen.

First, the tax problems. The IRS imposes a 7.5 percent federal excise tax (FET) on all "air transportation services," provided by any entity that owns an aircraft, controls the pilots, pays operating expenses and receives money for flight activity — just like your LLC. If the IRS decides that the LLC is an air transportation service when it flies you around, then FET liability can apply to the funding sources for the aircraft's operation, such as your contributions reimbursing the LLC for the aircraft's expenses. The tax liability can be huge. For example, if you contribute $500,000 to the LLC annually, the FET liability would be $37,500 per year. Normally, an IRS audit will tag a taxpayer for three years, so that's $112,500 in FET, plus interest and penalties, which could add up to a total cost of $200,000 or more.

Next, there's a hidden FAA problem. Most private aircraft flights are regulated under the relatively lenient Part 91 of the Federal Aviation Regulations, which applies to aircraft operated by and for the aircraft's owner with its own pilots. However, when you "compensate" an LLC for flights, the FAA can claim that Part 91 does not apply and that the LLC is actually a charter company that should have had an FAA operating certificate under the more onerous Part 135 for commercial charter operations. So the LLC would be subject to FAA fines of up to $11,000 for each violating flight and the pilots might lose their licenses.

And if several hundred thousand dollars in back taxes and fines were not bad enough, putting an aircraft in an LLC might actually offer less liability protection than other ownership structures.

Whether a plane is technically owned by an LLC or not, it still needs to carry liability insurance. But, in the event an accident occurs and the FAA determines that the flight was operating under Part 135, and not the Part 91 listed on the policy, then the insurance company can deny your claim. Plus, the improper FAA operation might make it easier for a plaintiff to lift the LLC's corporate veil and go after your personal assets, the very scenario that the LLC was set up to protect against.

So what's the answer? Well, you have several options, all classic examples of Costanza "opposite" thinking.

One is to keep the LLC structure, but do not let the LLC fly its own aircraft. Instead, have the LLC "dry lease" you the aircraft (as compared to a "wet lease," which is the lease of an aircraft with crew and other services). In a typical dry-leasing structure, you agree to pay fixed hourly or monthly rent to the LLC for use of the aircraft, hire your own crew and pay all direct operating costs, such as fuel, oil and landing fees. (If you co-own the plane with friends, such as Elaine and Jerry, all those leases will need to fit together, particularly in the area of flight scheduling, or it's unlikely you'll be friends for long.) By properly using this structure, you'll maintain your Part 91 status, there should not be any FET and liability protection is achieved through liability insurance.

As an alternative, the LLC can dry lease the aircraft to a charter operator, which, in turn, can charter the aircraft to you. This structure is more expensive because of higher maintenance standards for the aircraft and charter-operator fees, and there will be FET that the charter company will pass onto you, but it is a lawful structure and any liability will fall onto the charter operator.

Finally, you can get rid of the LLC entirely and just own and use the plane outright or with your friends as tenants in common. This is certainly a simple solution. Through your liability insurance you'll likely have the same protection you would have through an LLC. And, yes, now you'll truly be the master of your domain.