

# PUBLICATION

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## Many Corporate Aircraft Operators are Operating Illegally Without Realizing it – The Flight Department Company Trap

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The flight department company trap is a unique facet of aviation law that takes the liability protection of a Limited Liability Company (LLC) and turns the LLC into a liability itself. If your aircraft is owned by an LLC and (1) the LLC's only assets are the aircraft and related assets, (2) the LLC doesn't have another substantive business besides owning the aircraft, and (3) there is no dry lease in place to another entity that will operate the aircraft, then you have very likely fallen into the flight department company trap.

### Flight Department Companies

What is a flight department company? In the simplest terms, it's an entity whose *sole function* is to operate an aircraft. It's common for attorneys to use LLCs to segregate assets with potential significant liability from other businesses and assets, but if the LLC's sole asset is the aircraft, then what other purpose does the LLC have? None, besides operating the aircraft.

From a regulatory standpoint, the Federal Aviation Administration's (FAA) concept of a flight department company comes from the definition of a "commercial operator," which states that a commercial operator is a company or individual who "for compensation or hire, engages in the carriage by aircraft in air commerce of persons or property . . ."<sup>1</sup> *Compensation* is very broadly defined by the FAA, including among other things, intangible benefits, capital contributions, and reimbursement of expenses. It goes further than that; Federal Aviation Regulations (FAR) state that, "Where it is doubtful that an operation is for 'compensation or hire', the test applied is whether the carriage by air is merely incidental to the person's other business or is, in itself, a major enterprise for profit."<sup>2</sup> Multiple FAA Chief Counsels' opinions have interpreted this to mean that the analysis isn't solely whether the entity receives compensation, but also whether the operation of the aircraft is the entity's sole purpose or merely incidental to its primary business.<sup>3</sup> To be clear, commercial operations are permitted if the operator holds a commercial operating certificate, such as an airline or charter operator, but obtaining and maintaining a commercial operating certificate is an expensive and time-consuming endeavor that almost never makes sense for anyone other than an airline or commercial charter operator.

### Consequences of Operating a Flight Department Company

The first, and most obvious, consequence of operating a flight department company is an FAA enforcement action. The applicable statutes provide for fines of up to \$25,000 USD *per flight*.<sup>4</sup> The FAA isn't the only federal government agency that could issue a violation because, under certain circumstances, a federal excise tax could also apply to each flight by the flight department company.<sup>5</sup> Presuming this hasn't been properly paid to the Internal Revenue Service, it will result in not only back taxes, but interest and potential fines as well.

Further, potential violations also come with reputational damage to the alleged violator. The FAA regularly publishes press releases announcing its *proposed* civil penalty for an alleged violation but does not issue follow-up press releases or retractions if their enforcement action results in a lesser penalty or warning letter.<sup>6</sup> Thus, even if the alleged violator is able to successfully defend or justify their operations to the FAA, the reputational damage may have already been done.

The FAA is usually alerted to these violations as the result of an accident or incident, and, depending on the extent of the accident and the value of the aircraft, the regulatory penalties could be a drop in the bucket compared to the fact that the operation of a flight department company might void the applicable aviation insurance coverage. Most, if not all, aviation policies issued to non-commercial operators have standard exclusions that void coverage if the aircraft is operated commercially or if the aircraft is being operated in violation of FARs. If the operator has a mortgage on the aircraft, there's most likely a covenant in the mortgage that obligates the client to operate the aircraft in compliance with laws at all times.

It is also worth noting that the FAA has been increasingly focused on illegal Part 91 operations that cross the line into commercial operations. Indeed, the FAA instituted a dedicated hotline and website, managed by the National Air Transportation Association (NATA), where suspected illegal charter operations can be reported.<sup>7</sup> Information gathered by the NATA through these sources is passed along to the FAA's special investigative team based in Fort Worth, Texas.

### How to Avoid the Flight Department Company Trap

The first, and simplest, solution is to have one of your primary operating companies (i.e., entities that conduct your primary business, unrelated to aviation) also serve as the operator of the aircraft. This may be a scary proposition given the perceived potential liability resulting from aircraft operations, but aviation insurance can mitigate that risk. While it doesn't provide complete separation of liability that would be achieved by keeping the aircraft operations in a separate entity, proper aviation insurance coverage should address most of the significant risks associated with owning and operating an aircraft.

Given that the flight department company analysis focuses on operating an aircraft, it's a common practice for tax planning purposes to create an LLC to own the aircraft, and then lease it to another entity (that is not itself a flight department company) to operate the aircraft. This structure works because an LLC can *own* an aircraft without running afoul of the FAA regulations – it just can't *operate* it. These types of structures implicate many other legal considerations and potential pitfalls and are just one part of a comprehensive aircraft ownership/operating structure that should only be implemented by experienced aviation attorneys.

Combining the concept of operational control with the flight department company analysis arrives at the result that a party must generally operate its own aircraft and will have difficulties shielding itself from the liability of operating an aircraft by using a separate company. There are other alternatives and possibilities, including using a charter operator under Part 135 of the FARs to operate your aircraft for you, but each option has its own advantages and drawbacks and should be carefully considered.

### Conclusion

As you can see, the flight department company trap is easy to miss, and it is but one example of the myriad ways that individuals and companies can unintentionally violate FARs. The only sure way to avoid a costly violation is through soliciting the advice of a qualified aviation attorney early in the process of buying and operating an aircraft.

This article provides a brief overview of the flight department company trap. Please note there are additional, complex aspects of the flight department company trap, and the summary above is not intended to be comprehensive. If you or your company have any questions about owning and operating an aircraft please contact [Jim Janaitis](#), [Alex Marriott](#), [Trey Range](#), or one of Baker Donelson's other aviation attorneys.

<sup>1</sup> 14 C.F.R. §1.1

<sup>2</sup> Id.

<sup>3</sup> See, e.g., Legal Interpretation to Lawrence Williams, from Lorelei Peter, Assistant Chief Counsel (Dec 4, 2017); Legal Interpretation to James E. Cooling, from Lorelei Peter, Assistant Chief Counsel (Aug 22, 2017); Legal Interpretation to Elizabeth Wadsworth, from Rebecca MacPherson, Assistant Chief Counsel (Jan 27, 2006); Legal Interpretation to Kevin Y. Jung, from George Thompson, Assistant Chief Counsel (March 22, 1996).

<sup>4</sup> 49 U.S.C. §46301(a)(1).

<sup>5</sup> 26 U.S.C. §4261; Rev. Rul. 76-394, 1976-2 C.B. 355.

<sup>6</sup> See Press Release, Federal Aviation Administration, FAA Proposes \$1M Fine Against Aircraft Resource Management for Illegal Charter Flights (Jan. 18, 2023); Press Release, Federal Aviation Administration, FAA Proposes \$1.1M Fine Against Rosado Aviation, Inc. for Alleged Illegal Charter Operations (July 18, 2022); Press Release, Federal Aviation Administration, FAA Proposes \$1.38 Million Civil Penalty Against Campbell Oil & Associates in North and South Carolina (Oct. 8, 2021).

<sup>7</sup> National Air Transportation Association, <https://www.nata.aero/advocacy/avoid-illegal-charter.aspx#:~:text=If%20you%20suspect%20illegal%20charter,posed%20by%20illegal%20charter%20schemes> (last visited April 13, 2023).