

## A Guide to Owner Trusts

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Owner trusts have been a commonly accepted means to register aircraft in the U.S. for many years, and play a critical role in the business aviation industry. However, the current rules applicable to owner trusts are sometimes misunderstood. This article will explain the uses and benefits of owner trusts, discuss the related obligations and address some common misconceptions.

### What Is an Owner Trust and How Is It Used?

The U.S. is the most popular jurisdiction worldwide in which to register an aircraft. The reasons for relying on the U.S. for aircraft registration include a consensus that the Federal Aviation Administration (FAA) has established among the highest standards for aircraft operation and maintenance in the world. Aircraft on the U.S. registry generally maintain their value better than similar aircraft that are registered elsewhere. Also, the U.S. is a center for global business, and aircraft owners and U.S. businesses, including the well-developed general aviation industry, mutually benefit from growing domestic and international aircraft activity in the U.S.

The federal government restricts who may register aircraft in the U.S. Violations of these restrictions may result in significant financial penalties and even jail time.<sup>2</sup> The code and regulations provide that individuals who are U.S. citizens or resident aliens, and partnerships that are comprised solely of individual U.S. citizens, may register aircraft in their own name. Corporations and limited liability companies formed in the U.S. may register if:

- a. their president is a U.S. citizen, at least two-thirds of their board of directors are U.S. citizens, and at least two-thirds of their directors or other managing officers (excluding the president) are U.S. citizens;
- b. the corporation or LLC is under the actual control of U.S. citizens; and
- c. at least 75 percent of the voting interest is owned or controlled by U.S. citizens.

The above test applies not only to the applicant for registration, but in theory to each voting interest holder down to the ultimate individual owners.

The narrowly drafted provisions relating to citizenship exclude certain companies that most would otherwise consider as domestic. For example, a partnership in which the first partner is an individual U.S. citizen, and the second partner is a U.S. corporation that is wholly owned and managed by the same individual, does not qualify as a U.S. citizen for aircraft registration

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<sup>2</sup> The requirements for registration are set forth in 49 U.S.C. Sections 40102(a) and 44102(a), 14 C.F.R. Section 47 and rulings and guidance from the FAA. Penalties are set forth in 49 U.S.C. Sections 46301 and 46306.

purposes as not all the partners are individual U.S. citizens. Similarly, a large publicly traded U.S. corporation that has, at any time, more than 25 percent of its voting shares owned or controlled by non-U.S. citizens, or that has a non-U.S. citizen president, would also fail the citizenship tests.

The registration options for entities that do not fit under one of the above categories are limited. A corporation that fails the citizenship tests, but was formed and operates in the U.S., may register an aircraft so long as the aircraft is based in the U.S. and at least 60 percent of all flights in each six-month period of ownership are within the U.S. Also, corporations that fail the voting control test, but otherwise satisfy the citizenship test for corporations, may hire an independent voting trustee to hold the voting rights for the shareholders.

While these two structures are useful occasionally, they can only be used by U.S. corporations and can be cumbersome in practice. The more common alternative for non-citizens who wish to register an aircraft in the U.S. is an owner trust.

An owner trust is a relationship where a trustee holds legal title to the aircraft for the benefit of a third party, who is commonly called the “trustor” or “beneficiary.” The trustee then leases or licenses the aircraft back to the trustor/beneficiary or a third party, as the trustee does not operate the aircraft. When an entity doesn’t meet the narrow U.S. citizenship definition for registering an aircraft, owner trusts are often used, and referred to as a “non-citizen trusts” or “NCTs.”

Owner trusts are frequently used by aircraft leasing companies, and other businesses that own multiple aircraft, to facilitate registration, and are often integrated into financing arrangements for aircraft fleets, in addition to being used by owners of single aircraft.

Under an owner trust, the beneficiary or its lessee operates the aircraft (perhaps with the assistance of a management company), hires the crew and pays the expenses. The trust documents obligate the beneficiary or other parties to operate the aircraft in accordance with the manufacturer’s specifications, the requirements of the insurance policy and applicable law. The income tax attributes associated with the aircraft pass through to the beneficiary. The aviation industry is very familiar with owner trust structures, so such trusts have no adverse impact, and in some cases are useful from financing, management and tax planning perspectives.

#### **Additional Rules Applicable to Owner Trusts**

Federal regulations provide that when legal title to an aircraft is held in trust, the trustee must be a U.S. citizen or a resident alien. The applicant for registration must submit to the FAA:

- a. a copy of each document legally affecting a relationship under the trust; and
- b. either (i) an affidavit that each beneficiary is either a U.S. citizen or a resident alien or (ii) if one or more of the beneficiaries is not a U.S. citizen or a resident alien, an affidavit that the trustee is not aware of any reason, situation or relationship as a result of which such beneficiary or beneficiaries would together have more than 25 percent of the power to influence or limit the trustee’s authority.<sup>3</sup>

In 2013, after a thorough review of owner trusts that lasted several years, the FAA issued a Notice of Policy Clarification for the Registration of Aircraft to U.S. Citizen Trustees in Situations Involving Non-U.S. Citizen Trustors and Beneficiaries (the “Policy Clarification”).<sup>4</sup> The FAA stated that the purpose of the Policy Clarification was to “ensure that the use of non-citizen trusts to register aircraft is fully consistent with the applicable regulations and supports the FAA’s safety oversight interests...” and that it “...will facilitate the FAA’s ability to determine eligibility for registering aircraft to non-U.S. citizen trusts.”

The Policy Clarification required that certain provisions be included in trust documents, instituted a new process for submitting all documents relating to the trust to FAA for review, and attached a pro forma trust agreement. Among other things, the FAA confirmed that the trust documents must specifically provide that non-U.S. citizens may not directly or indirectly hold more than 25 percent of the power to remove or direct a trustee.

The Policy Clarification further provides that upon request, third-party trustees have obligations to provide the FAA with information about the operators and operations of the aircraft held in trust. Specifically, the FAA expects trustees to respond with the following information within two business days:

- The identity and residential address or principal place of business of the person normally operating, or managing the operations of, the aircraft
- The location of maintenance and other aircraft records
- Where the aircraft is normally based and operated

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<sup>3</sup> 49 C.F.R. 477(c)

<sup>4</sup> Federal Register, Vol. 78, No. 117, Tuesday, June 18, 2013, Page 36412

The FAA additionally expects trustees to provide the following information within five business days:

- Information about the operator, crew and aircraft operations on specific dates
- Maintenance and other aircraft records
- The current airworthiness status of the aircraft

The pro forma trust agreement also specifically obligates the trustor to expeditiously provide information related to the aircraft and operations to the FAA and trustee upon request.

Following the issuance of the Policy Clarification, each of the leading owner trust providers modified their form documents to conform with the revised trust agreement and the other priorities in the Policy Clarification. The trust providers also instituted and continue to maintain policies and procedures to accommodate the FAA's information requests, in addition to performing their own due diligence searches.

Finally, pursuant to the Policy Clarification and related guidance, all trust agreements and any operating agreements between the trustees and non-citizen beneficiaries are filed with the FAA as a public record.

### **Working With Your Owner Trust Provider**

There are several respected owner trust providers in the U.S. Once hired, the provider will first request information about the beneficiary, the operator and the aircraft. Usually the provider will give the beneficiary a questionnaire with instructions to help simplify the information collection process. Additionally, the provider will require that the beneficiary identify one or more people who can respond quickly and accurately to future FAA requests for information. Finally, the provider will check the "watch lists" and run due diligence on parties involved in the proposed transaction to help protect against bad actors. Since many aircraft transactions are time-sensitive, it is very important that the beneficiary respond to the provider's requests with complete and accurate information in a timely manner. Trust providers typically review such information and request updates from their beneficiaries at least annually.

In addition to the information requirements described above, the Policy Clarification and subsequent directives from the FAA mandate that the trust documents need to be submitted to FAA Aeronautical Center Counsel ("ACC") in Oklahoma City prior to being filed for recording, to assure that the documents conform to the code, regulations and other guidance relating to owner trusts. The review process can sometimes take a few days, so it is important for the beneficiary to build in sufficient time prior to closing to obtain ACC approval.

Also, since the trustee will be the registered owner of the aircraft, the trustee will need to be named on the aircraft insurance. Since all parties will want the insurance coverage to be effective and in the proper form when the aircraft is placed in trust, it is recommended that the beneficiary contact its insurance provider and give the proposed certificate and endorsements to the trustee for review at least several days prior to the closing.

### **Retaining Advisers and Coordinating With Other Parties**

Aircraft are valuable assets requiring significant technical expertise, so it is a best practice for the beneficiary to hire a qualified aviation attorney to draft the agreements and monitor the closing process. Additionally, regulations relating to aircraft operations are complex, and aircraft may operate in multiple jurisdictions, so the beneficiary should carefully review its plans for use of the aircraft with qualified advisers. Finally, aircraft may be based and/or operated outside the U.S., so the beneficiary should seek guidance on preferred methods to export and import the aircraft, if applicable.

Placing an aircraft in a trust, and its use and storage, also require careful advance tax planning. The adviser can alert the beneficiary to the types and approximate amounts of taxes that will result from its intended use and operations to prevent expensive surprises and provide guidance on tax planning. The adviser may recommend such things as:

- using existing business entities or forming new entities to hold the beneficial interest in or to operate the aircraft
- coordinating tax planning with the delivery location of the aircraft
- entering leases or other contractual relationships based on tax policies the state or other jurisdiction where the aircraft will be primarily based and operated

When an aircraft is placed in a trust, several parties are typically involved in the transaction. For example, the escrow agent or closing attorney will need to be made aware of the trust structure and can assist in obtaining ACC approval. If a lender is involved, they will need to review the trust documents and draft their loan documents to reflect that title to the aircraft will be held in the name of the trustee. It is often necessary to request that a seller transfer title directly to the trustee. The beneficiary will want to contact such parties as early in the process as is reasonably possible so that everyone is ready on the scheduled closing date.

## The Future of Owner Trusts

The FAA and aviation industry have worked together to greatly improve the system for registering aircraft through owner trusts. The specific obligations discussed in the Policy Clarification and subsequent guidance regarding the collection of information about aircraft operations, providing such information to the FAA upon request, and filing supporting documents relating to the relationship of the parties with the FAA, are unique to owner trusts. The major owner trust companies have gone even further, by implementing their own due diligence processes. The aviation industry is committed to continuing its work with the FAA on owner trusts to ensure that they remain a viable aircraft registration option for many years to come.