

When Your Client Wants to Buy an Airplane

A Primer for Michigan Lawyers

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At a Glance

Owning and operating an aircraft for personal or business travel is a great solution for many clients, but aircraft transactions combine traditional concerns like inspections, due diligence, and allocation of risk with unique aviation law-related concerns such as regulatory compliance, liability minimization, and tax considerations.

Advising a client wanting to own and operate their own aircraft can present an interesting challenge. Recently, we reviewed a draft purchase agreement for a client and after we described several transactional and liability concerns, the client, eager to make a trip in his new aircraft, quickly dismissed those concerns by saying, “That’s all nice, but you’ve got to understand — this plane takes off like a rocket!”

Clients are often (and understandably) enamored with the convenience and joy associated with having their own aircraft. Nonetheless, it is important that lawyers understand and properly address the transactional and liability issues involved in purchasing and owning an aircraft for business or personal purposes.

This article summarizes and addresses these issues for Michigan lawyers. It focuses on the purchase of used aircraft because most aircraft transactions are purchases and sales of used aircraft and new aircraft purchases are largely dictated by the manufacturer’s documents and requirements.



Like most people, more and more clients are looking for ways to maximize their time and efficiency while avoiding dangers, including terrorism and pandemics. Owning and operating an aircraft for personal or business travel is a great solution for many clients, who often seek advice from lawyers regardless of whether their attorney has such transactional experience. Aircraft transactions combine traditional concerns like inspections, due diligence, and allocation of risk with unique aviation law-related concerns such as regulatory compliance, liability minimization, and tax considerations. The purchase agreement is a good place to start a review of these issues.

Purchase agreement issues

An aircraft purchase agreement should include all critical transaction terms — the parties, price, deposit, inspections, resolution of discrepancies, title search, seller warranties, sales taxes, closing date, delivery, and survival of warranties. The

purchase price of an aircraft may be subject to many variables, and it is important for both buyer and seller to consider a variety of resources to help establish a fair price. Those include Aircraft Owner and Pilots Association resources, listings and sale transaction databases, broker opinions, and appraisal services.¹ Each aircraft is unique and there can be substantial variations in value due to damage history, maintenance and overhaul history of the engines and equipment, avionics (e.g., aircraft with glass cockpits and the latest avionics will bring a premium while those with original steam gauges may justify a discount),² and its history of use (e.g., an aircraft used heavily in training operations versus one owned and operated by one or two careful owners).

The purchase agreement should also address the following issues, many of which are unique to aircraft transactions:

1. **Title search.** A title search of the aircraft, engines, and propellers using the Federal Aviation Administration (FAA) Registry³ and the International Registry⁴ will disclose any existing bank liens, mechanics liens, certain tax liens,⁵ and other claims against the aircraft and against certain engines and propellers.⁶ Banks and mechanics are notorious for failing to properly release liens in the FAA and International registries. Title companies with aircraft expertise are typically based in Oklahoma City, Oklahoma, where the FAA Registry is located. These title companies can assist parties not only by conducting the required title search, but also by providing helpful escrow services and aircraft transaction expertise, as necessary.
2. **Comprehensive logbook review.** The value of an aircraft depends partly on the completeness and accuracy of its logbooks and damage history. Logbooks and records also confirm whether the aircraft complies with any airworthiness directives (which are issued by the FAA and are mandatory) and service bulletins (which are issued by the manufacturer and provide recommended service work). Both notices are important in that they identify past mechanical and maintenance issues that may be expensive to address and resolve. Many types of aircraft have specific and unique maintenance issues, so it's important to ensure that the aircraft has been properly maintained and an experienced mechanic has reviewed comprehensive compliance records.
3. **Physical inspection.** A prepurchase inspection of the aircraft will tell the buyer whether there are any deferred maintenance issues and whether the engine, systems, equipment, and avionics are operating properly and as represented. A comprehensive prepurchase inspection also minimizes the chance for any post-closing surprises and may identify maintenance issues that the buyer might require the seller to resolve before closing.
4. **Inspections by independent shops/mechanics.** For the buyer's inspection, it is important to use an independent maintenance shop experienced with the specific type of aircraft. Shops with type-specific experience know where to look for type-specific maintenance problems. It is also important that the inspection facility be independent; a shop that has serviced the aircraft in the past might have an incentive to please the seller and validate existing records and maintenance practices.
5. **The cost to resolve discrepancies.** The purchase agreement should permit the buyer to terminate if inspections are unsatisfactory. It should also allow the buyer and seller to allocate among themselves the cost to resolve any airworthiness or non-airworthiness discrepancies (and logbook and title discrepancies). Typically, the agreement allows the buyer to propose a purchase price reduction in an amount sufficient to resolve airworthiness discrepancies and describes a process for the parties to resolve other discrepancies as well. We find that about 80% of independent prepurchase inspections pay for themselves by identifying repairs or deferred maintenance items that a reputable seller might contribute toward resolving once the seller is aware of the issue. It is generally considered fair for the seller to pay (at a minimum) the costs to resolve all title discrepancies as well as those categorized as airworthiness discrepancies.
6. **Sales and use taxes.** Most state laws require the buyer to pay the applicable sales and use taxes. The purchase agreement should specify the location of the closing for tax purposes, and the buyer's attorney should carefully review whether a state sales or use tax will apply. Many states (including Michigan) permit "fly-away" exemptions from sales/use taxes — the tax does not apply if the aircraft leaves the state and does not return within a specific time after closing.⁷ But a closing that occurs outside of Michigan does not mean that the Michigan sales/use tax does not apply. Use taxes in many states, including Michigan, apply to out-of-state closings if the aircraft will be permanently or routinely located in Michigan (including an aircraft based in Michigan for more than 90 days in a calendar year).⁸
7. **Avionics, equipment, and software.** All equipment, software, and other aircraft-specific items should be referred to in the purchase agreement and included in the sale. This includes avionics and equipment manuals, warranty records, data cards, tugs,⁹ covers, winterization kits, extra parts, wheel fairings,¹⁰ battery tenders,¹¹ pilot operating handbooks, airworthiness certificates, maintenance records, licenses, and permits.
8. **Bills of sale.** The agreement should require execution and delivery of FAA Bill of Sale Form AC 8050-2¹² and a separate warranty bill of sale. That form includes standard preprinted language, typically refers to consideration of \$1, and is filed with the FAA Registry. The warranty bill



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of sale typically specifies the purchase price and recites any seller warranties from the purchase agreement.

9. **Choice of law, jurisdiction, and venue.** Since aircraft are transitory by nature and since the buyer and seller are often located in different states or countries, it is especially important to consider and expressly designate the parties’ agreed-to provisions regarding choice of law, jurisdiction, and venue.

The purchase agreement should describe in detail the closing process once the inspections and title searches have been completed, including when and where possession of the aircraft will be transferred.

Transaction and closing issues

Both federal and state laws apply to aircraft transactions. Aircraft ownership and lien records are filed with the FAA Registry, and state contract law and state sales and use tax rules also apply. Therefore, an aircraft closing requires compliance with applicable federal and state rules.

The relevant FAA and state closing documents include the following:

1. FAA Bill of Sale with original ink signatures or FAA-approved electronic signatures (FAA Form AC 8050-2).
2. Warranty bill of sale.

3. Notice of Lien Recordation and Release (FAA Form AC 8050-41).
4. Federal registration application (FAA Form AC 8050-1).
5. For aircraft buyers that are limited liability companies, the LLC Statement in Support of Registration of U.S. Civil Aircraft in the Name of an LLC.¹³
6. State registration application (Michigan Form M-4004).
7. State sales and use tax forms (Michigan Forms 1989 and 4281).

Title companies based in Oklahoma City, where the FAA Registry is located, are experts in the field and well worth the cost to provide escrow services for a closing. Larger aircraft transactions may also include registry on the International Registry.

In Michigan, an Application for Michigan Aircraft Registration (Form 4004)¹⁴ must be filed with the Michigan Department of Transportation, and the buyer is required to file an Aircraft Transfer Questionnaire (Form 4281)¹⁵ and a Tax Calculation for Nonqualified Aircraft Transfer (Form 1989)¹⁶ with the Michigan Department of Treasury. In addition, the buyer must submit proof of the aircraft purchase price; this may include the signed purchase agreement, the warranty bill of sale, or both. The state’s 6% sales/use tax applies to the fair market value of the aircraft. Therefore, if a buyer pays a below-market price, state treasury authorities may ask for evidence of fair market value. If the state challenges that evidence, an appraisal from an experienced and properly certified aircraft appraiser may be necessary to establish fair market value.

In certain circumstances — and when a fair market rental rate is used — Michigan aircraft buyers may be able to pay a 6% use tax on rental income instead of sales tax. This approach requires ongoing tax payments and administrative compliance as well as proof of the aircraft’s fair market rental value.

Transfers of Michigan aircraft that do not involve any change in beneficial ownership (e.g., a transfer from an individual to a limited liability company entirely owned by the individual) and certain other aircraft transfers do not require paying state sales or use taxes. Permissible tax exemptions are set forth on the Michigan Aircraft Transfer Questionnaire (Form 4281) including exemptions for transfers from certain relatives, agricultural use, transfers to or from a wholly owned business, a claim of resale, and inheritance. Be prepared, however, to submit documentation supporting the exemption and, in the case of a business transfer, proof that the transferor paid the sales/use tax when originally acquiring the aircraft.

While warranties, software, records, and ancillary equipment may be afterthoughts, it is critical to include these items in aircraft transactions. To continue to rely on manufacturer warranties, the buyer must complete all warranty transfer documents to ensure the proper transfer of any avionics, engine, or service warranties. Further, it is critical for the buyer to obtain the complete and uninterrupted logbooks for both the aircraft and the engines at closing to preserve the value of the aircraft.

Ownership options

There are a variety of ways to own an aircraft under federal aviation regulations: as an individual, partnership, corporation, association, LLC, trust, co-ownership, and fractional ownership. Ownership arrangements have significant consequences for liability exposure and regulatory compliance. Aircraft-owning clubs and entities like partnerships and multiple-owner LLCs are a great way to reduce ownership expenses, but it's important to review and understand the contract rights and liabilities of each person or entity involved in a business, co-ownership, or club arrangement. Carefully consider the best ownership arrangement for your circumstances and get specialized legal advice from an experienced aviation lawyer. The article by Whalen, Dixon, and Comazzi in this issue of the *Michigan Bar Journal*¹⁷ offers helpful suggestions and considerations for how best to own and operate an aircraft.

Tax benefits of aircraft purchase

Businesses purchasing a new or used aircraft may be entitled to tax incentives under § 168(k) of the Internal Revenue Code.¹⁸ Specifically, the Tax Cuts and Jobs Act of 2017 implemented changes that permit a business to depreciate 100% of the cost of qualified property classified as a business expense — including the purchase of an aircraft — until January 1, 2023. Subsequently, bonus deductions are reduced by 20% per year until 2027.¹⁹

Depreciation recapture rules may apply when a business aircraft is used for personal travel more than 50% during the tax year. Therefore, business professionals seeking personal use for their aircraft should be aware that the bonus depreciation afforded under § 168(k) of the code could be at risk should personal use amount to more than half of the aircraft's use.

When an aircraft is used for business purposes, a deduction may be permitted for the costs associated with that travel. These complex and detailed rules require guidance from an experienced aviation tax attorney or certified public accountant.

Conclusion

Like many transactions, purchasing and owning an aircraft requires careful consideration of a variety of factors: regulatory compliance, inspections, due diligence, title searches, closing issues, state and federal registration, insurance, and an appropriate ownership structure. Because of the unique nature of these issues, it is a good idea to get expert legal advice from a lawyer with experience in handling aircraft transactions in Michigan.

Remember, all this planning and documentation is necessary for your client, who will almost always be excited to just “kick the tires and light the fires!” ■



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Ethan J. Beswick is a corporate attorney at Varnum LLP with a background in mergers and acquisitions, tax, real estate, and aircraft matters. An instrument-rated commercial multi-engine pilot, he has experience with buying and selling aircraft, aircraft leasing arrangements, and operational considerations. He is well versed in aircraft tax planning and provides counsel on aircraft tax matters related to depreciation planning, state sales and use tax planning, and federal excise tax planning. Ethan is also the founder of West Michigan Young Aviators (WMYA).

ENDNOTES

1. AOPA, VREF Aircraft Valuation, *Buying or Selling an Aircraft? Then You Should Have This!* <<https://www.aopa.org/go-fly/aircraft-and-ownership/buying-an-aircraft/vref-aircraft-valuation>> [https://perma.cc/R4V3-5JJ8]. All websites cited in this article were accessed July 4, 2021.
2. Avionics include aircraft systems and equipment that inform the pilots of flight-related data.
3. See Federal Aviation Admin, Licensing and Certificates, *Aircraft Registration* (May 25, 2021) <https://www.faa.gov/licenses_certificates/aircraft_certification/aircraft_registry/> [https://perma.cc/VS2D-7YSU].
4. See International Registry of Mobile Assets, *Welcome to the International Registry* <<https://www.internationalregistry.aero/ir-web/aboutUs>> [https://perma.cc/B6FU-YJCH].
5. Federal tax liens are not recorded in the FAA registry.
6. *Aircraft Registration and Welcome to the International Registry*. In both registries, security interests in engines may be filed only for engines that have at least 550 hp (or 1750 lbs of thrust). In the FAA Registry, security interests in propellers may be filed only against propellers that have at least 750 takeoff hp (or 1875 lbs of thrust). Interests in propellers may not be filed in the International Registry.
7. MCL 205.94.
8. MCL 205.93.
9. An aircraft tug is used to move the aircraft on the ground.
10. Some aircraft have removable wheel fairings which improve aerodynamic efficiency.
11. Battery tenders regularly cycle the aircraft's battery while not in use, which provides for a longer battery life.
12. Most of the FAA forms and applications discussed in this article may be found at Federal Aviation Administration, *FAA Forms* <<https://www.faa.gov/forms/>>.
13. Statement in Support of Registration of US Civil Aircraft in the Name of an LLC, sample available at <https://www.faa.gov/licenses_certificates/aircraft_certification/aircraft_registry/media/LLC%20format.pdf> [https://perma.cc/2LVB-RXXM].
14. Michigan Dept of Transportation, *Aeronautics, Aircraft Registration* <https://www.michigan.gov/aero/0,4533,7-352-79155_79167--,00.html> [https://perma.cc/H4VY-8TV7].
15. Available at Michigan Department of Treasury, *Michigan Taxes, Aircraft* <https://www.michigan.gov/taxes/0,4676,7-238-74531_103919-544831--,00.html> [https://perma.cc/YF84-3NHQ].
16. *Id.*
17. Whalen, Dixon & Comazzi, *Leasing Structures and Associated Risks: Avoiding "Illegal Charter" Operations*, 100 Mich B J 24 (July/Aug 2021), an article in this issue that provides an excellent summary of the subject.
18. 26 USC 168(k).
19. *Id.*