FLIGHT-WATCH

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AIRCRAFT OWNERSHIP TRUSTS AND VOTING TRUSTS

I. Overview

A United States corporation or citizen may act as an owner/trustee for a foreign national or foreign corporation provided the beneficiary of the trustee has no control over the ownership, retains no incidents of ownership, cannot terminate the trustee, and there is no other relationship between the trustee and the beneficiary other than the trust agreement. This is an aircraft Ownership Trust. Ownership Trusts must be very carefully drawn, and they must generally be approved by the FAA before recording. The hazard for the beneficiary under ownership trusts is the owner trustee as the owner and could sell or mortgage or hypothecate the aircraft. This exposure for the owner must be remedied by obtaining fidelity insurance in the event the trustee breaches the terms of the trust agreement. The danger for the trustee is that the beneficiary will incur liability for which the trustee must answer. For example, what happens if the beneficiary flies into Class B Airspace without a clearance and a civil penalty is incurred? The beneficiary must indemnify the trustee from liability associated with the operation of the aircraft.

What happens if a United States corporation is more than twenty-five percent (25%) owned by a foreign entity? The shareholders of the corporation can transfer at least 75% of their aggregate rights and powers to a voting trustee who qualifies as a U.S. citizen ("Voting Trustee").

II. The Statute and the Regulations

According to 49 USC §44102(a), "An aircraft may be registered under Section 44103 of this title only when the aircraft is —

(1) not registered under the laws of a foreign country and is owned by —

(A) a citizen of the United States;

(B) an individual citizen of a foreign country lawfully admitted for permanent residence in the United States; or

(C) a corporation not a citizen of the United States when the corporation is organized and doing business under the laws of the United States or a state, and the aircraft is based and primarily used in the United States.

Based upon reading 49 USC §44102(a)(1)(A), (B), we know that an aircraft may be registered in the United States either by a citizen or by a person lawfully admitted for permanent residence. So this would indicate that a resident alien could register the aircraft in addition to a United States citizen. The provision found in 49 USC §44102(a)(1)(C) only comes into play when "a corporation is not a citizen of the United States, when the corporation is organized and doing business under the laws of the United States or a state, and the aircraft is based and primarily used in the United State." So this requirement involves a commitment to operate the aircraft primarily in the United States. If the corporation is not going to be based primarily in the United States, then the requirements of 49 USC §44102(a)(1)(A), (B) must be satisfied.

While the statue (49 USC §44102) does not specifically address owner trustees, the regulations do. 14 CFR §47.7 expands and amplifies on the authority found in 49 USC §44102. For example, 14 CFR §47.7(a) declares that with respect to U.S. citizens, an applicant for aircraft registration who is a citizen must make a certification to that effect on FAA Form 8050-1. Then, 14 CFR §47.7(b) requires that with respect to resident aliens, the applicant for registration "must furnish a representation of permanent residence and the applicant's alien registration number issued by the Immigration and Naturalization Service." So if the aircraft is going to be registered by a trustee, then the applicant owner must be a United States citizen under §47.7(a) or a resident alien under §47.7(b).

We next turn to the provisions in the regulations dealing with owner/trustees. This is found in 14 CFR §47.7(c) which provides: Trustees. An applicant for aircraft registration under 49 USC Section 44102 that holds legal title to an aircraft in trust must comply with the following requirements:

(1) Each trustee must be either a U.S. citizen or resident alien.

(2) The applicant must submit with the aircraft registration application —

i. A copy of each document legally effecting a relationship under the trust;

ii. If each beneficiary under the trust, including each person whose security interest in the aircraft is incorporated in the trust, is either a U.S. citizen or a resident alien, an affidavit by the applicant to that effect; and

iii. If any beneficiary under the trust, including any person whose security interest is incorporated in the trust, is not a U.S. citizen or resident alien, an affidavit from each trustee stating that the trustee is not aware of any reason, situation, or relation ship (involving beneficiaries or the persons who are not U.S. citizens or resident aliens) as a result of which those persons together would have more than 25% of the aggregate power to influence limit the exercise of the trustee's authority.

(3) If persons who are neither U.S. citizens nor resident aliens have the power to direct or remove a trustee, either directly or indirectly through the control of another person, the trust instrument must provide that those persons together may not have more than 25% of the aggregate power to direct or remove a trustee. Nothing in this paragraph prevents these persons from having more than 25% of the beneficial interest in the trust.

So as one reads 14 CFR §47.7(c), one appreciates: (1) the trustee must be a citizen or resident alien, (2) a copy of the trust agreement must be submitted to the FAA, (3) if the beneficiary under the trust is a U.S. citizen or resident alien, there must be an affidavit to that effect, (4) if the beneficiary under the trust (including any person with a security interest in the aircraft) is not a U.S. citizen or resident alien, then there must be an affidavit from each trustee stating the trustee is not aware of any reason as a result of which non U.S. citizens will have more than 25% of the aggregate power to influence or limit the exercise of the trustee's authority, and (5) if persons who are not U.S. citizens or resident aliens have the power to direct or remove a trustee, either directly or indirectly, the trust must provide that those persons may not have more than 25% of the aggregate power to direct or remove a trustee, provided that does not prevent foreign nationals from having more than 25% of the beneficial interest in the trust. Items 1 through 4 above generally apply to ownership trusts and the requirements to be satisfied in registering an aircraft made under an ownership trust. Item 5 above deals with a voting trustee to ensure a foreign person or entity does not have more than 25% of the power to direct or remove an ownership trustee. A voting trustee may be needed to satisfy the requirement of an ownership trust.

There is a limitation on the ability to employ trust agreements, since 14 CFR §47.43(a)(4) provides:

> (a) The registration of an aircraft is invalid if, at the time it is made —
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> (4) The interest of the applicant in the aircraft was created by a transaction that was not entered into in good faith, but rather made to avoid (with or without the owner's knowledge) compliance with Section 501 of the Federal Aviation Act of 1968 (49 USC §1401).

Even if the applicant for registration under an owner trustee arrangement satisfied the requirements of the statute, the FAA always has an out (i.e., a way of denying the application) if the FAA maintains that the registration is not presented in good faith.

III. Letters of Interpretation of the Ownership Trusts Arrangement

In FAA Interpretation 1982-6, a letter from Joseph T. Brennan of the Aeronautical Center to Felix D. Bates of August 2, 1982, the FAA declined to approve the registration of a Gulfstream Commander 690 on the basis that the registration was "pending completion of registration in Columbia." It is important to remember that in order for an aircraft to be registered in the United States, it must "not be registered under the laws of a foreign country." 49 USC §44102(a)(1). Since the intention was ultimately to register the aircraft in Columbia, the FAA had an argument that it did not meet the requirements of 49 USC §44102(a)(1) and therefore the application for registration was not in good faith. In denying the application for registration, Mr. Brennan, writing on behalf of the FAA declared:

> Assuming, for the sake of discussion only, that the transaction was acceptable under the provisions of §47.43(a)(4) of the Federal Aviation Regulation, since the sole beneficiary is neither a citizen of the United States nor a resident alien, it is our opinion that, under circumstances such as exist here, the trustee must be able to exercise totally independent judgment with respect to all decisions involving the aircraft. Also, it is our opinion that, for the trustee to be able to provide the affidavit required under §47.7(c)(2)(3) of the Federal Aviation Regulations, there can be no other relationship between the trustee and beneficiaries other than that created by the trust. For example, there cannot be a lessor/

> lessee or bailor/bailee relationship insofar as the use of the aircraft is concerned. If the trust is to meet the requirements of the regulations, there should be no contact between the trustee and beneficiaries, advisory or otherwise regarding any or all decisions relating to the aircraft. This would include the sale of the aircraft. In that regard, the trust could provide, by specific terms, how any sale was to be conducted including the method of determining the selling price.

In FAA Interpretation 1981-56, a letter from Mr. Brennan to H. Randolph Williams of December 22, 1981, the applicant had submitted an aircraft registration under a proposed trust agreement. One of the beneficiaries under the trust would have no power to direct or remove the trustee but would have the right to approve "any sale, exchange or disposition of the aircraft." In denying the trust agreement approval, Mr. Brennan noted:

> It is our opinion that on the basis of the stated purpose of this transaction, and the terms of Article II, Paragraph 1, of the proposed trust agreement relating to the utilization of the aircraft, the aircraft could not be registered to the trustee under the proposed transaction.

The Letter of Interpretation from Mr. Brennan to Mr. Randolph went on to recite the same paragraph quoted above as appeared in FAA Interpretation 1982-6. It does appear that an impediment to approval of the trust agreement in FAA Interpretation 1981-56 was the fact that a foreign trustee beneficiary had the right to approve the sale of the aircraft by the owner trustee. Arguably a voting trustee agreement could have solved this problem. In other words, a voting trustee could have been created to ensure the foreign entity could not exercise more than 25% of the power over the ownership trustee.

In FAA Interpretation 1982-5, a letter from Mr. Brennan, Aeronautical Center Counsel, to Preston G. Gaddis, II dated July 29, 1982, Mr. Brennan was called to determine whether the FAA would permit recording of a trust agreement among Finalco Equipment Investors, III, First Security Bank of Utah, NA and Robert S. Clark. The trustees reserved the beneficial and equitable interests in the trust estate (which presumably included the aircraft), and Mr. Brennan wrote, "We do no recommend re-use of this declaration." Secondly, the trust agreement directed that the owner trustee appoint the beneficiary as the agent for the trustee with full power to do any and all such acts as the corporate trustee or individual trustee might do. With regard to this provision in the trust agreement, Mr. Brennan wrote:

> We have strong reservations about this arrangement, since the trustees then have no duties to perform except to execute appropriate documents of transfer, mortgage, etc., with all normal incidence of ownership (insurance, maintenance, operation, etc.) being performed by the beneficiaries, or, in this case, by the lessees. It seems the cleaner method would have been to assign the agency authority to the lessee under the lease, rather than write these incidents of ownership out of the beneficiaries, who must then assign them again to the operator/lessee.

Mr. Brennan went on to approve the trust agreement noting: "The persuading factor in this case is that all parties are U.S. citizens, and there is no question of countervailing interest by non-citizens."

FAA Interpretation 1982-5 appears to be illuminating only to the extent that it illustrates the kinds of clauses beneficiaries may employ trying to retain ownership over the corpus of the trust (the aircraft). Apparently, the only reason this trust agreement was approved is because the beneficiaries were United States citizens. Without question, had the beneficiary been a non U.S. citizen, recording of the trust agreement could not have been approved by the FAA.

IV. Conclusion

Before an aircraft can be registered in the United States, 49 USC §44103(a)(1) requires that the application for registration meet the requirements of 49 USC §44102. §44102 requires that the application for registration be submitted by a United States citizen or an individual citizen of a foreign country lawfully admitted for permanent residence in the United States (49 USC §44102(a)(1)(A), (B)) or a corporation not a United States citizen when the corporation is organized and doing business under the laws of the United States or a state, and the aircraft is primarily based in the United States (49 USC §44102(a)(1)(c)).

The requirements of the regulations dealing with owner trustees are specific and have been discussed above in this article. Clearly, by virtue of the FAA interpretations discussed above, the Agency does not want to have foreign corporations or foreign citizens having any power or influence over the conduct or actions over the United States citizen or resident alien trustee. It is further clear that when submitting an ownership trust and/or a voting trust together with any associated agreements, that approval of Aeronautic Center counsel is going to be a pre-requisite to the filing application for registration.

As the text set forth in this article suggests, ownership trusts and voting trusts must be carefully and thoughtfully drawn in such a manner as to not offend any of the requirements of the FAA, and the only relationship between the owner/trustee and beneficiary must be the duties set forth in the trust agreement. Of concern to the beneficiary is the fact that the owner trustee is in fact the "owner" of the aircraft. A prudent beneficiary would require a fidelity bond, a fidelity insurance policy in force and effect to protect the beneficiary in the event the trustee were to assign the aircraft, to convert the aircraft, or to otherwise sell the aircraft in breach of ownership trust agreement. On the other hand, the owner trustee must be mindful of the fact that it has the legal obligation to the United States government in relation to the operation of the aircraft. Operational violations involving the aircraft may result in the assessment of civil penalties or fines against the aircraft owner trustee. Similarly, because of the potential for a catastrophic loss with damages flowing therefrom, it would necessitate that the owner trustee be named as the insured on the applicable policy of liability and comprehensive insurance associated with the ownership and operation of the aircraft.

If the aircraft is to be operated under a lease or on a 135 operating certificate, then any such documents should involve an entity or entities other than the owner trustee under the trust agreement. Besides insuring that the aircraft is fully insured, the owner trustee would certainly want to have indemnification from the beneficiary of the trust in the event that the owner trustee were to incur liability as a result of acting on the behalf of the beneficiary. The requisite documents to the registration and operation of the aircraft must be submitted to the FAA and approved before recordation of interests in the aircraft and before operations of the aircraft commence in the United States.

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