



Where to Register an Aircraft

By:

Derek Bloom, Partner
Capital Legal Services, Moscow, Russia

and

Gianni Rizzello, Partner
KLEIN, Attorneys at Law, Zürich, Switzerland

When buying an aircraft, the place of its registration is one of the most important questions in connection with its future operation. This article summarizes the principal planning considerations for an owner of an aircraft who is in Russia or a CIS country.

The decision in favor of a specific country of registration will vary on a number of circumstances. Such circumstances can be in particular: the place of business of the chosen operator, the level of regulation, the cost, the requirements of a financing bank, the level of privacy and asset protection, questions of registration of ownership and other interests in aircraft (e.g. mortgages), questions of taxation as well customs issues relating to importation, the “prestige” of a specific registration, the specific operation of the aircraft (commercial / private / corporate), questions of technical certification of an aircraft (e.g. EASA/FAA) and a number of other factors.

As a general starting point and before making any “hasty” decisions, it is highly recommended to do a thorough analysis of the intended use of the aircraft. This will include a number of considerations which cannot be given in all detail in this article. It will certainly include a thorough assessment of the intended aircraft routing, the mode of operation of the aircraft (private / commercial / corporate), the intended number of hours and their potential allocation for private / commercial transport, the structuring of ownership, the financing of the aircraft and many other factors.

Once such an analysis is accomplished, further investigation could be done into the place of registration of the aircraft.

Oftentimes the decision of the place of registration is made by an owner based on the consideration of what “others do”. This can work out just fine but can also be a most treacherous approach. Actual requirements of aircraft owners tend to vary significantly from each other and rarely full and complete information is shared among different owners. As a matter of fact it often occurs that a specific owner is not even aware of some significant disadvantages that a specific registration may offer to such an owner.

The place of registration should actually be decided upon ideally well before the aircraft is purchased. In case of purchasing a new aircraft, the manufacturers will want to know well before delivery the country for the aircraft certification and an according certificate of airworthiness for export will be issued to that extent. In case of purchase of a used aircraft, it should be investigated at an early stage

whether the choice of a specific place of registration will require technical adjustments of the aircraft such as implementation of service bulletins etc. Depending on the type of aircraft and its age and technical status, there can be very significant differences in the cost of technical compliance. As an example, an aircraft that was fully certified for EASA use was sold to a US buyer, requiring implementation of work required by a Service Bulletin at a cost of USD 150,000.

European and Off-Shore Registration

Once a decision is made whether to operate an aircraft privately or commercially, there are typically a number of registrations of choice. Oftentimes you will see for private registrations offshore registrations such as Bahamas, Cayman Islands, Bermuda or Aruba. However there are also a lot of European registrations used such as UK, Ireland, Isle of Man, Austria, Finland, Switzerland, Germany, Malta, Portugal and, as discussed below, it is a common choice to register an aircraft in the US. Registries such as Cayman Islands, Bermuda and Aruba have extended their attractiveness as place of registration by entering into article 83bis agreements according to the Chicago Convention with other states, thereby transferring supervision responsibilities to the state in which the aircraft is to be based and operated. Such agreements allow for easier aircraft operations based in specific countries outside of the place of registration, the most prominent example for commercial aircraft being Aeroflot aircraft registered in Bermuda, with a tail number in the VP-B[XX] series.

For some owners, attractiveness of registration is governed by consideration of where there may be a lower level of regulation. Certain places of registration such as the Isle of Man, Cayman Islands, Bermuda and Aruba e.g. have relatively easy and straightforward registration processes, even though there is a tendency that these processes become more regulated due to increased ICAO requirements. It is recommended to allow however sufficient time to register an aircraft (ideally anywhere between 4 and 8 weeks). Most places offer comprehensive and valuable guidance for the registration process and the relevant procedures and forms are published on well administered websites. It is advisable to check at an early stage what the requirements of the various places of registrations are with respect to ownership, as this may involve the incorporation of a local company, which can potentially be time consuming and require the involvement of a local law firm (e.g. Aruba and Bermuda). Another potentially time consuming issue is the requirement that a technical inspector needs to inspect the aircraft before it can be taken on the registry. Early coordination is well advised.

Private operation of an aircraft is typically much less regulated than commercial operation. The most “visible” consequence of a private operation for an owner is that there are fewer duty time restrictions on crew in private operations. A further advantage of private registrations is that there is a lesser cost for management and crew, etc. However there are some differences in fuel cost, e.g. there is a mineral oil energy tax on privately operated aircraft in Germany, Austria and Switzerland. Privately registered aircraft may obtain tax free fuel in Europe if the aircraft is operated within the “economic activity of an enterprise”.

Depending on the intended geographic use of the aircraft, Switzerland offers the possibility to register an aircraft privately, without importation of such aircraft into Switzerland. Outside of Switzerland this will allow for unrestricted operation of the aircraft, however certain limitations apply to flight from and to Switzerland.

In case an owner opts for a commercial operation of the aircraft, he is well advised to do a thorough tax assessment of a commercial operation. With respect to EU countries, VAT legislation plays an important part in such considerations. While European VAT law exempts aircraft from VAT if such aircraft are “*used by an airline operating for reward chiefly on international routes*”, the interpretation of this requirement differs in different European countries. It is highly recommended to obtain tax advice and possible tax rulings in the specific country of registration in order to avoid “unpleasant” surprises in connection with VAT. 0% VAT schemes such as practiced in Denmark had

to be abolished due to the pressure from the European Commission. It also appears as if the 0% VAT scheme practiced in the UK will become a “victim” of increased government spending.

Another consideration that should be given in the context of taxation is the structure of management / operation of the aircraft. Depending on where the management company is located and where management services are provided, the tax consequences may vary significantly.

When an aircraft is to be financed (or re-financed), it is advisable to coordinate the place of registration early with the financing bank. Typically, a bank will want to create a “statutory” mortgage on the aircraft, which will be registered on the aircraft in the jurisdiction of its registration (in places where no aircraft mortgages can be obtained a bank will typically structure the financing as a sale and lease back transaction, thereby being entered as owner in the registry). The main consideration of the bank will be that, in case of the owner defaulting on the financing, the bank will want to understand the process it will need to go through in order to enforce a mortgage and repossess the aircraft. The bank will thereby look at choosing a place of registration where it knows it can effectively enforce the mortgage and it is advisable to coordinate the decision where to register the aircraft early in the process with the bank, i.e. well before the delivery of the aircraft.

US Registration

A very frequent choice is for an aircraft to be registered in the United States and to receive a "N" registration. There are a number of reasons why "N" registrations remain the first choice of many aircraft owners. First, the US remains the largest market for the purchase and re-sale of corporate aircraft, therefore offering the greatest liquidity and quickest times for re-sale. Second, an aircraft that is maintained in accordance with the requirements of the FAA will have the fewest questions associated with it when it comes time for a pre-purchase inspection of the aircraft prior to its re-sale, and all records for the aircraft would have been maintained in English, again minimizing costs on re-sale. Third, the process to close an aircraft transaction is very straight forward and quickly accomplished under US law. Fourth, the US has the largest number of charter companies that can exploit an aircraft commercially thereby, potentially, covering the costs of the financing on the aircraft. Fifth, operation of an aircraft in accordance with FAA regulations is less costly for US charter operators than for European charter operators. Sixth, the US offers a high degree of anonymity to owners as a result of the practice in the US for aircraft to be registered in the name of a trust, and for the beneficiary of the trust not to be publicly disclosed.

The process to acquire an aircraft that will be registered in the US is that a Russian buyer will enter into an Aircraft Purchase and Sale Agreement with the selling legal entity, and this agreement will contain a clause providing for the right of the buyer to assign its rights under the contract to a trust. Once the agreement is fully negotiated, one of a few alternative US banks will be engaged to act as trustee and hold title to the aircraft.

The reason for use of a trust to be the beneficial owner of the aircraft is that the US Code and the US Federal Aviation Regulations (the "FAR") require that an aircraft may be registered in the US, and have an "N" registration number, only when it is owned: by a citizen of the United States, or by an individual citizen of a foreign country who is a permanent residence of the United States ("Resident Alien"), or by a corporation when the corporation is organized and doing business under the laws of the United States or a State. For buyers of aircraft who are not a US citizen, the most common means of meeting these requirements is through use of a trust. Section 47.7 of the FAR does not prevent foreign beneficiaries from having a majority, or all, of the beneficial interest in such a trust, with the trust being the registered owner of the aircraft.

Accordingly, an aircraft owned in this manner will appear in the records of the FAA as being owned by the bank involved. One US bank with a leading practice acting as trustee is Wells Fargo Bank. As

an example, if you go to this website where information is made publicly available by the FAA about who owns aircraft with certain N-numbers: http://registry.faa.gov/aircraftinquiry/NNum_Inquiry.aspx and enter in this number: 200GA, and press "Go", and you will see that this particular Gulfstream G200 is recorded as owned by the bank, acting as trustee, and the beneficial owner is not disclosed.

In May 2010, for a period of less than one week, there was some confusion about whether the FAA is considering changing its rules and practices in connection with use of trusts by non-citizens. It is clear that the FAA is not changing its position, and if anyone would like to learn more about the short debate that occurred in May, please contact the authors of this article.

When an aircraft purchase transaction closes and a trust is involved as described above, title to the acquired aircraft will pass directly from the selling legal entity to the bank acting as trustee. There will not be a back to back transaction where ownership passes to the legal entity that is the named purchaser in the aircraft purchase agreement.

Simultaneously with the closing of the aircraft purchase transaction, the trustee bank will enter into a further agreement, most commonly a lease agreement or an aircraft operating agreement to convey the right to operate the aircraft to an agreed party or parties. Most commonly, the designated user of the aircraft will be a US Part 135 charter company. The regulatory issue that was discussed in May concerned cases in which use of a US N-registered aircraft was passed back to the foreign trustor under the trust agreement with the bank.

Accordingly, this lease agreement or an aircraft operating agreement also needs to be negotiated, and the full budget and tax consequences of operating the aircraft analyzed in detail. Additional labor and tax planning will be required to come up with an optimal plan for the hiring of pilots, maintenance crew and cabin crew.

Russian Registration

It seems a safe prediction that the near future for business aviation in Russia will likely include more Russian registered aircraft. Today, the great majority, perhaps up to 95% of business jets owned directly and indirectly by Russian businesses and individuals, are registered outside of Russia.

While accurate statistics about Russian ownership of business jets are impossible to obtain, it is widely accepted that approximately 400 to 450 corporate jets are directly or indirectly owned by Russian corporations and individuals. Of these, approximately 25 are registered in Russia. If these figures are correct, approximately 95% of Russian-owned aircraft are not registered in Russia.

There are significant legal and liability risks for the owners of foreign-registered aircraft that are flown in Russia. Even if a one-time permit has been obtained from the Federal Air Transport Agency (Rosaviatsiya) for a domestic flight of a foreign registered aircraft pursuant to Prikaz No. 69, dated July 20, 2007, the insurance company that insures that aircraft will likely not pay a claim if an accident occurs. Second, if obtaining such permits, or the cooperation of the Russian Customs Service in looking the other way and not blocking a domestic flight of a foreign aircraft for a commercial purpose, involves any irregularities, then there are additional legal risks that the aircraft may be seized or other unexpected legal problems may arise. We know examples of the Russian Customs Service arresting aircraft and holding them to ransom until very significant sums have been paid.

Accordingly, leading Russian companies are coming to the conclusion that they are best off importing their aircraft in full compliance with the Russian tax and customs codes. There is an exemption from customs duties for business aircraft weighing up to 20,000 kg. The import VAT paid may be recovered over the months following an aircraft's import. Severstal has given a public presentation

about how it imported two Challenger aircraft, paid and recovered the VAT, and registered the aircraft on the Russian registry of rights to aircraft and transactions with aircraft created in March 2009.

The great majority of business jets owned directly and indirectly by Russian businesses and individuals will continue to be registered outside of Russia. This is primarily due to the requirements of foreign banks that prefer their loan, pledge and lease agreements be governed by non-Russian law; an expectation of reduced resale value if aircraft are based in Russia; superior maintenance facilities and FBO's outside Russia; lower costs outside of Russia; and greater confidence in the rule of law outside of Russia.

However, the trend will be toward a larger percentage of Russian-owned aircraft being registered in Russia, at least those aircraft owned by large Russian businesses where no financing is required.