



## Controlling the Liability of Aircraft Operators

*Part II of a series of articles designed to assist aircraft owners with proper integration of aircraft operations into their overall tax planning process.*

Operation of an aircraft by necessity involves some assumption of liability. Although entity design is important, the cornerstone of any protection plan should be an insurance policy with sufficient coverage to cover foreseeable losses.

### **An Insurance Policy Is Merely A Contract**

An aircraft insurance policy is a contract designed to compensate for designated losses, to designated beneficiaries for prescribed operations, made by qualified operators that are not otherwise excluded. Except when operating under commercial contracts, operations are limited to those qualified under FAR Part 91. This requires that the aircraft be legally maintained, and prohibits substantially all compensation for hire. In *Avemco Insurance v Auburn Flying Services*, 242 F.3d 819 (2001), the court held that the insurance company was relieved of a liability of a loss incurring from an operator who collected \$10 for a ride on his aircraft.

The policy will also identify qualified pilots by name, and generally provide an open endorsement for other pilots who meet certain minimum qualifications. The balance of the contract includes exclusions for areas of operations, and limitations on the right to subrogate an insurance company's right to recover from a third party. Subrogation agreements are not unusual, and are often proposed by both hangar-keepers and fixed base operators; an operator who allows a third party to escape liability from a subrogation agreement, may void his insurance contract. Operators are therefore cautioned to read and understand the rights and limitations outlined in these agreements.

### **Beyond The Limits of Insurance**

The current availability and cost of insurance has reached crisis level for many operators. For those that are forced to operate outside areas of potential coverage certain steps may be taken that will limit their liability.

If an aircraft is to be professionally flown, operators should make an effort to keep the pilots off of the company payroll. An operator who employs the pilots naturally assumes

liability for their negligence. The vehicle of choice for protection would generally be an independent management company that is well run and has high professional standards in both employment and execution of duties. In certain cases it will not be possible for the operator to allow a third party to employ the pilots. The pilots may be long-standing employees, and seek the fringe benefits provided to other company employees. In this scenario consideration should be made to the formation of a subsidiary which will provide identical fringe benefits to the pilots and enter into pilot service agreements with the operating company. Although this does not provide the same level of protection as an independent entity, it is preferable to the direct employment of the pilots.

If the aircraft is owner flown, little can be done to protect the pilot from his own negligence. Regardless of the title of the aircraft, or the nature of the operating agreements, the pilot will remain liable for his own errors. His best area of protection is therefore in the segregation of his assets between those attachable by creditors and those not. He may then create viable structures for asset protection, such as family limited partnerships, and asset protection trusts, that may serve to convert attachable assets to exempt ones. Finally, he should limit his risk by controlling who he invites as passengers on his aircraft.

There is no substitute for an adequate insurance policy, but when it is simply not available an operator should consider contractual, entity protection and good judgment as well. Through this combination he can often manage the financial risk of operations.

The next article will address structuring concerns related to the “Passive Activity Limitations” of the Internal Revenue Code.

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