

"WET" AND "DRY" LEASES

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Last month we explored the different shared aircraft ownership options and found that even though some of the differences were minor on paper, they were major in their impact on the Federal Aviation Regulations and the IRS rules. Well the same is true with leases. I am not talking about finance leases, I am talking about operating leases.

The FAA in their "Truth-in-Leasing" Advisory Circular (AC 91-37A) defines a wet lease as "a lease in which the lessor provides both the aircraft and the crew...." Leasing of an aircraft without crew is considered to be a dry lease. The IRS typically imposes the commercial Federal Excise Tax (FET) on wet leases AND the noncommercial Federal fuel tax on dry leases. This may sound relatively simple, but there are still some questions among operators as to where the lines may be drawn. An operation may pass the test for FAR Part 91, but be considered a commercial activity for FET purposes. Following are some of the common leasing arrangements and the Federal Excise Tax ramifications of each

WET LEASES

Timesharing – this operation is defined under FAR 91.501(c)(1) as an arrangement "...whereby a person leases his airplane with flight-crew to another person, and no charge is made for the flights conducted under that arrangement other than those specified in paragraph (d) of section 91.501." This is considered a wet lease because the aircraft is provided with crew. However, even though this is considered Part 91 the IRS considers this a commercial activity and although no profit is made, because of the restriction on charging, the commercial FET is due on the amounts paid and a credit or refund is allowed for the tax paid on the fuel burned for that flight.

Interchange – this operation is defined under FAR 91.501(c)(2) as an arrangement "...whereby a person leases his airplane to another person in exchange for equal time, when needed, on the other person's airplane and no charge, assessment or fee is made, except that a charge may be made not to exceed the difference between the cost of owning, operating and maintaining the two airplanes." This is also considered a wet lease as the aircraft and crew of one company is exchanged for the aircraft and crew of another. Even though in some cases no money changes hands, this is still considered a commercial operation for FET purposes and the commercial tax is due on the fair market value of the interchange and again a credit or refund is allowed for the tax paid on the fuel burned for that flight. Keep in mind that there are two fair market values to be considered, one is the IRSs and one is yours.

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Charter – this operation is conducted under FAR Part 135 and the operator must hold a commercial operating certificate. This is always a wet lease as the aircraft is provided with aircraft and crew to the end user. This operation is considered commercial both for FAA and IRS purposes and the commercial FET is due on the amounts paid, less catering, flight phones, limousine services obtained for the customer and separated stated on the invoice. In addition, a credit or refund is allowed for the tax paid on the fuel burned for that flight

DRY LEASES

"True" Dry Lease — as was stated before, a dry lease is a lease of an aircraft without crew. Typically in a dry lease the lessee is responsible for hiring the flight crew and has operational control of the aircraft. In these cases the lease is considered to be noncommercial and the lessee and the lessor are not required to hold an FAA-issued operator's certificate as long as the lessee is not carrying persons or property for compensation or hire. The IRS agrees with the FAA on dry leases and the commercial FET is not due on the lease payments between the lessee and lessor.

"Sham" Dry Lease — would be an example of someone trying to confuse the issue as to who has control of the aircraft. The typical case is where the lessor is providing the aircraft under a dry lease and is also providing the crew under a separate agreement. Another example would be where the lessor is leasing you the aircraft, but you have to get your crew from the lessor or a specified source. In both cases the plane and the crew are too closely connected. In the case of a "sham" dry lease or "damp" lease the FAA may take the position that the lessor should hold a commercial operating certificate. The IRS would more than likely consider the lessor to have possession, command and control and the commercial FET would be due on the lease and pilot service payments.

As you can see it is yours and everyone's best interest to understand what type of lease arrangement you are entering into and not be caught unawares by either the FAA or the IRS.

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