

A GUIDE TO BUYING A BUSINESS JET



by **Steven Quayle**
Director
Corporate Department
Cains Advocates Limited

Buying a business jet involves spending millions of pounds (or more likely dollars) on a complex asset that has the potential to create catastrophic liabilities for its owner. The directors of the proposed owning company need to manage the client's wishes, whilst discharging their duty to act in the best interests of that company.

This article contains recommendations for fiduciary service providers and particularly company directors on how to avoid some of the worst mistakes when buying a business jet.



INVESTIGATE TITLE

It is a misconception that the registered owner of the aircraft must be the legal owner. Many aircraft registers, including those of the Isle of Man and United Kingdom, also permit lessees to be registered owners. Like most other aircraft registers, the Isle of Man register cannot be relied on to provide conclusive evidence of legal ownership.

The buyer must conduct its own investigations and, in particular, review original 'back to birth' bills of sale for the aircraft. It should also conduct searches that would reveal any encumbrances registered against the aircraft. For example, by searching any mortgage register corresponding to the registration of the aircraft, the Cape Town Registry where applicable, and any charges register maintained by the companies' registry of the jurisdiction of incorporation of the seller.

The bill of sale in favour of the buyer should include a warranty that the seller is the legal and beneficial owner of the aircraft and that the aircraft is free and clear of all encumbrances. However, the seller is likely to be a single purpose company whose sole asset is the aircraft.

By the time the buyer would come to make a claim for any breach of warranty under the bill of sale or purchase agreement, the seller is likely to be either an empty shell or liquidated. The common solution is to obtain a guarantee of the seller's obligations from a company of substance connected to the seller. The guarantee should be retained for a period of years after the purchase of the aircraft.

INSPECT THE AIRCRAFT AND ITS RECORDS METICULOUSLY

Used aircraft are often sold "as is, where is" with the seller only being obligated to deliver the aircraft in an airworthy condition. The buyer should always require a pre-purchase inspection of the aircraft, its records and maintenance history by an independent engineer with expertise specific to that aircraft model. The inspection should be more about money than safety, where any shortcoming can be leveraged against the purchase price. Where a major discrepancy is discovered, the buyer may have sufficient reason to walk away from the deal and save itself millions in expenses down the road.

It is also customary for the buyer to conduct a short test flight as part of the pre-delivery inspection. The pilot on the test flight should be type rated and experienced flying that model of aircraft. The parties will need to ensure that, among other things, the aircraft is fully insured during the test.

If the aircraft has been flown between the time of the pre-purchase inspection and closing, a further check of the aircraft and its systems should be conducted immediately prior to closing.



OBTAIN JOINED-UP TAX ADVICE

Tax issues can influence every element of the purchase, including:

the physical location of aircraft at the time of purchase - with VAT or sales taxes being an issue in some jurisdictions, it is common for used aircraft to be flown to a tax neutral jurisdiction for closing;

the type of corporate vehicle used to acquire the aircraft - limited partnerships are sometimes used instead of companies due to potentially taxable benefit-in-kind issues associated with the client; and the jurisdiction of registration of the aircraft - this could differ depending on whether the buyer plans to charter the aircraft and on its plan for importing the aircraft into the EU. In the Isle of Man and United Kingdom, the standard rate of VAT on the importation of a business jet into the EU is 20 per cent.

The buyer therefore needs to consider the tax position in a range of jurisdictions in order to structure the aircraft's acquisition in the most tax efficient manner.



ENSURE THE USE OF THE AIRCRAFT IS LAWFUL

Where an aircraft is registered on a 'private' aircraft register such as the Isle of Man, any chartering or receiving other payment for flights in the aircraft is generally prohibited. As well as constituting a criminal offence, the activity will void the aircraft's insurances. This could leave the owning company and its directors' uninsured against potentially devastating third party claims for damages in the event of an accident involving the aircraft.

Particular care needs to be taken where an aircraft will be registered on a private register, but used predominantly for business use, and the buyer is seeking VAT registration. In this circumstance, it would usually be necessary to demonstrate that the aircraft will generate an income. However, in order to be lawful such income must derive from an exemption to the general prohibition on chartering and receiving payments (such as the exemption that permits chartering of an aircraft between related group companies).

DRAFT THE DOCUMENTS

The buyer should engage a lawyer to draft the letter of intent on its behalf. This letter sets out the principal terms of the deal and is the basis on which the purchase agreement is prepared. Deficiencies or oversights unfavourable to the buyer in the

letter of intent are difficult to rectify in the purchase agreement later.

Purchase agreements can be very different depending on which party drafts it. A seller's focus is on receiving payment from the buyer whilst offering minimal warranties. A buyer usually wants as much protection as possible in the form of warranties, covenants, indemnities and escrow arrangements. Consequently, a purchase agreement prepared for the seller could be as little as three pages long, whereas a purchase agreement prepared for the buyer will often be in the region of 30 pages. Even after several rounds of negotiation, a purchase agreement is likely to be more favourable to the buyer if the buyer's lawyer takes responsibility for the initial drafting.

USE SPECIALISTS

Don't go it alone, even if the client wants to keep professional fees to a minimum. As this article has hopefully highlighted, the correct professional assistance can potentially save the client millions by choosing the correct aircraft, structuring the purchase correctly and minimising potential liabilities.

The client should be using an industry expert or aircraft management company to identify suitable aircraft, arrange the inspections and negotiate commercial terms using their industry knowledge.

Use a tax advisor experienced with business jet transactions and particularly the VAT related issues. The Isle of Man is fortunate to have numerous industry experts employed by local accountancy firms and fiduciary service providers.

Finally, engage an aviation lawyer to prepare the documentation and oversee the acquisition. Make enquires about his (or her) experience and level of professional indemnity insurance. The minimum level of insurance required to be carried by law firms is often a fraction of a business jet's value and may be insufficient to cover a negligence liability in full, so it is important to check the level of 'top-up' cover carried.



The buyer should always require a pre-purchase inspection of the aircraft, its records and maintenance history by an independent engineer with expertise specific to that aircraft model.

Cains

Fort Anne, Douglas
Isle of Man, IM1 5PD
+44 1624 638300
law@cains.com