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## **6. Why should I care to avoid a situation where my aircraft lease is considered a wet lease that requires an air carrier or commercial operator certificate?**

If you want to operate a commercial flight under a wet leasing arrangement, unless one of the narrow exceptions of FAR 91.501 applies, you must among other things: (a) comply with the licensing requirements of the Department of Transportation, (b) comply with the safety licensing and operating standards of the FAA, and (c) comply with the security program requirements of the Transportation Security Administration. The operator of a commercial flight under a wet leasing arrangement may also be required to collect and remit various taxes to the Internal Revenue Service and to Customs & Border Protection. Failure to do any of the above can result in substantial civil penalties and, at a certain level, even criminal penalties. Additionally, the language of many individual aviation liability policies is written to cover only private aviation flights. So, if you inadvertently engage in commercial operations through a leasing arrangement, you might be doing so without the protection of the insurance policy that you purchased.

## **7. What does the FAA mean by “totality of the circumstances” in determining which party has operational control?**

To ensure that parties do not disguise wet leases as dry leases, FAA inspectors will look at several factors in determining which entity effectively has “operational control” of the aircraft under a leasing arrangement.

FAA guidance provides broad questions such as “who decides when maintenance is accomplished”, “who pays for airport fees” and “for whom do the pilots work as direct employees or agents” to aid parties and FAA inspectors in determining which entity has operational control and other FAA guidance.<sup>23</sup> The answers are factors to weigh in determining whether the lessor, lessee, or potentially the manager is actually in operational control, and is not intended to be a “required” checklist where the lessee must have all indicators of operational control. (These factors are discussed above in the *Part Two - Operational Control: Classification of an Agreement as a “Wet” or “Dry” Lease* section of this publication).

In practice, in a non-exclusive lease, the lessee will rarely if ever have all indicators of operational control. By weighting these factors, one can determine whether the lessee or the lessor is effectively in operational control. (For example, if based on the totality of the factors the lessee is in operational control, then the fact that some indicators of control remain with lessor does not make a dry lease into a wet lease).

In fact, from a safety perspective it often makes sense for the lessor to undertake certain tasks rather than the hourly renter/lessee. For example as discussed above (in the *Part Two - Operational Control: Exclusive Leases Vs. Non-Exclusive Leases - Additional Consideration for Non-Exclusive Leases* section of this publication), the lessor may perform maintenance, but the lessee would still need to understand that for any particular flight in which it is in operational control, it should determine, or instruct its pilots to determine, that the aircraft is airworthy by conducting routine pre-flight checks. (See discussion of delegation of responsibility by the responsible person in Question 20).

## **BEST PRACTICES FOR “DRY” LEASING AND OPERATION CONTROL**

### **8. What agreements are recommended for a dry lease arrangement?**

It is always recommended, and in many cases legally required, that you have a written lease agreement signed both by the lessor and the lessee. For the lessee to be able to prove that it has operational control of the leased aircraft, it is strongly recommended that the lessee have written agreements for the crewmembers that it directly employs or that it engages and uses through sources other than the lessor (or anyone owned or controlled by the lessor).

In the lease agreement, the following elements should be addressed in addition to the other customary business terms for such agreements. This list is by no means exhaustive.

- The requirements of the FAA’s Truth in Leasing rules (FAR 91.23), if applicable.
- An acknowledgement by the lessee of the authority and responsibility that it is assuming as it takes possession of the aircraft under this lease and operates it. In addition to this acknowledgement of operational control responsibility, it is important that the lessor and lessee document when and how the operational control will be shifted between them during the course of the lease. For a long-term, exclusive lease, this is easy. For short-term, non-exclusive leases, this becomes more important, because possession and control may move back and forth among two or more parties.

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<sup>23</sup> FAA Advisory Circular AC 91-37B, § 6.3 and FAA Order 8900.1 Vol. 3, Chapter 13 § 6, 3-507.



**13. If we do not want to bother with making such a lease and having separate crewing arrangements, may we carry passengers for free? May we accept capital contributions from the parent company as a way to offset the cost of operating the free passenger flights?**

Carrying passengers for free is one way to ensure that a flight is not deemed commercial. However, if the flight is labeled free while payments are made in an alternative form, such as a recurring capital contribution to the company that is operating the flight, your flight may be considered commercial anyway. To help assess the appropriateness of a capital contribution to a company, you can look to see whether the contribution is used to run the general affairs of the business entity or is actually being made to cover the costs of the aircraft operations. You also should consider whether the contribution provides the funding necessary to purchase and preserve the aircraft as an asset, or whether the contributed funds really offset operational costs for the aircraft. Finally, if there is no business in that company other than the aircraft itself, then the company will be considered to be a flight department company that must obtain commercial certification to operate the aircraft.

**14. We do not charge others for being passengers on our flights. We only have our own employees on the aircraft. But we do want our customers to reimburse us for the cost of these flights because it was a travel expense for our business. Is this okay?**

If you only carry your own company's employees or property as passengers or cargo without receiving compensation, then it does not appear that you are providing a commercial transportation service to others. With respect to the carriage of customers who are not employees, the general rule is that you cannot seek compensation for those flights. That said, if your operation does qualify for the exceptions found in FAR § 91.501, you may be able to seek pro rata reimbursement for flights that are conducted incidental to and within the scope of your own business activity in accordance with 91.501(b)(5).

**15. Do these commercial-versus-private and dry-versus-wet leasing considerations change if our company hires a management company that also holds a DOT air taxi registration and FAA Part 135 air carrier certificate?**

If the aircraft operations are conducted by and under the exclusive operational control of a management company that holds a Part 135 certificate then these are commercial flight operations. It is also common for such management arrangements to provide for Part 91 operations by the owner, or for owners to dry lease the aircraft to a related entity on a non-exclusive basis. However, in such cases, all of the requirements discussed in the guidance regarding dry leasing and operational control would apply.

For example, a typical scenario is where the aircraft owner is an entity that does not operate the aircraft (because of the flight department company rule) but rather leases the aircraft on a non-exclusive basis to one or more beneficial owners of the aircraft owner entity for such beneficial owner/lessee's use. Each lessee would separately contract for pilot services, which may be obtained from the aircraft owner entity's management company. Provided the lessees contractually have operational control and understand their responsibilities as operators for those flights, such an arrangement generally does not raise the same types of concerns about "illegal holding out" or "devious leasing" arrangements, such as those described in these guidelines. And in fact, there are a number of aspects that enhance safety including: having the same pilots that are routinely assigned to the aircraft for charter operations, flying as agents of the beneficial owner/lessee for beneficial owner/lessee's Part 91 flights, and the management company providing a higher level of maintenance oversight. In addition, the management company should ensure that its POI has reviewed such arrangements for compliance with the FAR.

**16. Can related parties hire the manager of the aircraft (that is not a certificated air taxi operator) to provide pilot services, to support a non-exclusive dry lease from the owner?**

Similar to the scenario described in Question 15, sometimes an aircraft owner entity will hire a non-certificated manager to manage an aircraft, and because of the flight department company rule, the aircraft owner entity will lease the aircraft to each beneficial owner with each beneficial owner separately contracting for pilot services, typically from the manager. As with Question 15, this generally does not raise the same concerns as multiple-dry leases to unrelated parties and is a common practice. However, the parties would still need to ensure that as between the lessees and manager in particular, it is clear that each lessee, rather than the manager, is in operational control of flights.

**17. Does it matter to the FAA if we have multiple dry leases? Is there a limit on the number of dry leases we can have?**

There is no set rule on the number of dry leases you may lawfully have.

For example, it is normal for small aircraft rental companies to lease out their aircraft to private operators for mere hours or days at a time, resulting in many leases for each aircraft in the course of a year. There is nothing wrong with this so long as the lessee in each case obtains its own crew apart from the lessor, and so long as the lessee otherwise exercises operational control as described in the law and summarized in this guide.

However, if there were a number of leases of the aircraft to unrelated lessees who all hire the same pilots, the FAA would look closely at whether there was a “holding out” of air transportation, and the leases may be construed as illegal wet leases. See discussion in Question 1. In addition, FAA instructions suggest that “[i]f an aircraft is on numerous leases, dry or wet, the office should give greater consideration to conducting a ramp inspection, as a large number of leases may indicate that a lessor is attempting to circumvent part 119 requirements.”<sup>24</sup>

Further, if your company is planning to have more than one lessee for its aircraft, you should verify that you are not directly or indirectly providing or selecting the crew that will be used by any lessee. It is also a best practice to be aware that the closer your lease price is to prevailing charter rates, the more likely it may be suspected by government authorities as an unauthorized wet lease.

**18. There are only so many pilots in our area with the right qualifications to fly the aircraft we are leasing. Can a lessor and lessee ever use the same pilots? Can separate lessees use the same pilots?**

There is no clear rule on this. In each case, you must make sure that the engagement with the pilots is not given by, directed by, or otherwise controlled by the lessor of the aircraft. The lessor can have a say in the pilot standards that will be applied (e.g., license requirements and safe operating history) but the lessor must not be involved in providing the crewmembers. Further, the pilots hired should not have any financial interest in the aircraft or employment relationship with the lessor.

**19. Evaluation of a leasing arrangement appears to be a complex and somewhat subjective analysis; How will the FAA enforce these requirements? And how does this fit with the FAA new compliance program?**

We expect the FAA will be aggressive in taking action where operators are deliberately using sham leasing arrangements to hold out transportation to the public. We would expect to see the use of civil penalties, cease and desist orders, and potential suspension or revocation of certificates for pilots involved, especially those who were knowingly complicit in such actions. Even in cases where a pilot contends that he or she did not understand the legal implications of a lease arrangement, the FAA may still seek legal enforcement action based on circumstantial evidence.

Although the FAA may not review every lease after receiving a notification as required by truth-in-leasing requirements, when the FAA does review arrangements as part of truth-in-leasing filings prior to any flights under those agreements, anecdotally we believe that inspectors may advise parties if the arrangements raise issues of potential non-compliance.

Where the FAA reviews existing arrangements involving related party leases, during a ramp check or otherwise, and determines that there has not been an effective transfer of operational control to the lessee, but that there does not appear to be any attempt to hold out to the public or intentional conduct to violate the regulations, we anticipate that, consistent with FAA compliance program, the FAA would work with the parties to educate and correct the parties rather than immediately take enforcement action. However, if the FAA takes the position that the matter is not within the scope of the compliance program, then it is likely to be resolved with legal enforcement action which can include certificate suspension or revocation and civil monetary penalties.

**20. I understand as lessee, I am responsible for operational control - can I delegate performance of some tasks I am responsible for?**

The short answer is yes. For example, you may contract with a manager to provide pilots, who will pilot the aircraft as your agents, perform flight planning, and handle logistics. Similarly, you can delegate to the pilots to perform pre-flight checks to meet your responsibility for determining the airworthiness of the aircraft. From a safety perspective it is imperative that licensed pilots and mechanics perform key functions. However, it must be clear both contractually and in practice that you as lessee under a dry lease are ultimately responsible for these functions, even if delegated.

**21. Does a dry lease trigger any tax consequences?**

Generally speaking, the answer is yes. Leasing revenue and related expenses may have federal and state income tax implications. Leasing activities may also trigger sales/use tax obligations at the state and/or local level. Anyone engaged in a dry leasing activity should consult their tax advisor to determine how to properly structure and report the activity.

**22. Does operational control have an impact on lessor or owner liability?**

Yes. The FAA Reauthorization Act of 2018 confirmed the pre-emptive effect of 49 USC sec. 44112(b). That statute provides for lessor and/or owner liability for personal injury, death, or property loss only when the aircraft is in the actual possession or operational control of the lessor or owner. Therefore, the relevance of operational control is not limited to an analysis of FAR compliance.

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<sup>24</sup> Order 8900.1 Vol. 3, Chapter 13 Section 6, 3-504(d).



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