

FAA Scrutinizes Non-Citizen Trusts

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For more than 30 years, individuals and business entities which desired to “**N**” register an aircraft in the United States but could not certify that they met the U.S. citizenship requirements under the **Federal Transportation Code**^[1] have relied on **non-citizen trusts (NCTs)** to effect U.S. registration. Aircraft owners, operators and financing parties have employed NCTs and relied on the **Federal Aviation Administration’s (FAA)** pertinent regulations and course of conduct for legal compliance.^[2]

NCTs have many legitimate business purposes. A non-citizen purchaser might temporarily register an aircraft pursuant to an NCT while it is being modified in the U.S. before being exported and delivered to another country. Non-U.S. citizen operating or finance lessors often use NCTs when registering aircraft leased to U.S. airlines. Many financing parties require U.S. registration to take advantage of benefits attributable to the aircraft being maintained under the FARs and more favorable commercial remedies, particularly remedies under the **Cape Town Convention**, if available. Moreover, non-U.S. citizen lenders that repossess an aircraft may use an NCT to register the aircraft. NCTs are essential for “N” registration of corporate aircraft being operated by many U.S. companies that do not satisfy U.S. citizenship requirements. In certain circumstances, without NCTs, non-U.S. citizen aircraft owners might not have any registry available.

During the spring of 2010, the FAA raised doubts about NCT registrations. The aviation industry warned the FAA that any change in the FAA’s approach would effectively serve as a moratorium on NCT-registered aircraft, with a variety of unintended consequences. The FAA ultimately agreed to resume its long-standing procedures regarding NCT registration. However, the FAA did note that it would continue to scrutinize the use of NCTs. After deliberating for almost one year, the FAA issued a public notice to the industry, scheduling an open hearing on June 1, 2011 in Oklahoma City. The notice included a series of questions on the use of NCTs to be addressed at the hearing. Aviation industry participants submitted comments responding to the notice and engaged in formal and informal exchanges with the FAA at the June 1 meeting.^[3]

The takeaways from the June 1 meeting were comforting to industry participants who attended. First, it is unlikely that the FAA will issue regulations or opinions rendering all NCT arrangements invalid. Second, many of the FAA’s NCT-related concerns appear resolvable by revising the standard form NCT trust agreements, including strengthening the trustee’s control of essential aircraft-related

matters. Third, changes to the NCT process might be made so that trustees can better serve as a resource to the FAA for information about trustors/beneficiaries, operators and operations of NCT-registered aircraft, including by establishing further NCT-related information reporting mechanisms. At the June 1 meeting, and by follow-up submissions to the FAA, aviation industry advocates offered additional comments and proposed resolutions addressing the FAA's NCT-related concerns and urged the FAA to further collaborate with industry participants regarding any actions that may be taken to address these concerns, all while maintaining a "status quo" treatment of NCTs while the FAA's evaluation continues.

As of the writing of this summary, the FAA has not responded to the industry's comments and proposed resolutions to the FAA's concerns. The least intrusive change resulting from the FAA's recent NCT-related activities might be its imposing additional reporting requirements on operators to the extent not already covered by existing regulatory requirements, but consistent with (i.e., not modifying) existing U.S. aviation law. However, as always, it is difficult to predict how the FAA ultimately will address NCTs, and financing parties and lessors should continue to monitor the FAA's position on NCTs and be particularly wary of efforts to extend any compliance requirements to passive parties having an interest in an aircraft.

^[1] Generally, (i) a corporation only qualifies as a U.S. citizen if its president and 2/3 of its other managing officers and directors are U.S. citizens, and 75% its voting shares are held by U.S. citizens, and (ii) a partnership qualifies as a U.S. citizen only if it is owned solely by natural persons who are U.S. citizens.

^[2] NCTs are discretionary trusts established by one or more beneficiaries that are not U.S. citizens for purposes of registering an aircraft with the FAA registry. NCT trust agreements must contain provisions complying with the pertinent regulations, including ceding certain "control rights" to the trustee.

^[3] Representatives of the FAA attributed the recent NCT scrutiny to concerns involving its responsibilities to monitor, enforce and ensure compliance with the airworthiness and maintenance standards required of FAA-registered aircraft; failure to satisfy these responsibilities could lead to a potential dereliction by the U.S. of its duties as a Chicago Convention contracting state. It also is likely that NCT-related concerns have been raised by homeland security and drug enforcement officials.

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