

Business Law for DERs

A Brief Survey of Laws Affecting DERs and Their Businesses

Thank You To:

- **MARPA – Modification and Replacement Parts Association**
 - Non-profit trade association representing aftermarket parts manufacturers (PMAs)
 - MARPA has DERs as members
 - MARPA is committed to supporting the aftermarket manufacturing community – and DERs and an essential part of that community

Thank You To

- FAA LA ACO
- Stephen Kolb - Senior Engineer, Propulsion Branch
- All of you, for making the commitments necessary to be great DERs, and for taking the time in your busy schedules to attend required training

Who Am I?

- Aviation attorney representing
 - Manufacturers
 - Repair stations
 - Air carriers
 - Distributors
- Served on FAA ARAC Committees:
 - To rewrite organizational delegated privileges under 14 C.F.R. Subpart 183(d)
 - To rewrite Part 21 manufacturing regulations

Outline

- Due Process for the DER (Can I Appeal a FAA Decision Affecting My Privileges?)
- Tort Liability for the DER (Can *I* Be Sued?)
- Choice of Entity for the DER (Should I Incorporate?)
- Choice of Tax Structure for the DER (What is an S Corporation?)

Due Process for DERs

- FAA v. Lopez & FAA v. Steenholdt
- FAA Orders say:
 - DERs can appeal termination decision
 - DERs are entitled to final order stating termination reasons and addressing defenses raised
- FAA did not state which reasons were basis, nor did FAA address DER's defenses
- DER brought FAA to court!

Court Decision

- Court of Appeals
 - refused jurisdiction on case
 - stated that FAA procedural violations were not prejudicial
 - Reminded the public that there is no requirement for the formalities of a hearing in the termination or non-renewal of a DER

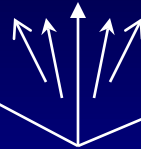
Lessons Learned

- Designations are fragile things - Be Careful!!
- Pay attention to your relationship with your FAA Advisor – your continued privileges are at his or her discretion
- You can be terminated at any time, for any reason
- Address FAA employee concerns
 - Promptly
 - Completely
 - To the satisfaction of your FAA contacts

Have You Heard This?

I'm doing work on
behalf of the FAA;
I can't be sued!

Can Be Sued



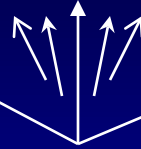
Can't Be Sued

- US has sovereign immunity
- US may be sued under Tort Claims Act
 - There is a discretionary function exception
 - Gov't officials enjoy “qualified immunity”
 - Acting within scope of discretionary authority
 - Conduct does not violate clear statutory or constitutional standards
 - But this does not apply to non-discretionary functions!

Discretionary Function Immunity

- Issuing some certificates may be mandatory
 - e.g. a type certificate issued upon demonstration of compliance
- But the *manner of review by FAA* is discretionary
- Leaves some questions
 - Is data review by DERs a discretionary function?
 - If “NO” then there’s no possibility of qualified immunity
 - Are DERs considered government employees?
 - If “NO” then there’s no possibility of qualified immunity

Can Be Sued



Can't Be Sued

- Tort Claims Act applies to employees
 - but not to contractors
- FAA position is that DERs are not employees of the FAA

DERs DO Get Sued

- Relying on law that is not on your side to begin with is not a safe way to conduct business
- My law firm has represented parties in several disputes in which DERs were threatened with suit

DER Liability Summary

- There are *limited* exceptions from liability
- But I would not rely on them
- Work closely with your FAA Advisor and other FAA resources to help make sure work is completed properly
- Doing the job right is the best protection from liability – *but even the best engineers get sued!*
- Consider insurance as a means of protecting yourself in the event of threats of liability

Some Types of Insurance

- Workman's Compensation
- Commercial multi-peril policy
- Professional Liability / errors and omissions
- Liability insurance covering premises, activities, and products
- Business interruption insurance
- Surety and performance bonds
- Employee fidelity bonds

Business Structure for the DER

- State Level Decisions
 - Choice of Entity
- Federal and State Level Decision
 - Tax structure

Why Think About Structure?

- Tax Consequences
- Liability consequences
- Investors
- Taking on a partner
- Selling the business to another professional

Choice of Entity for the DER

- Sole proprietorship
 - Partnership
 - LLC
 - Corporation
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- This is a separate but related issue from tax structure!

Sole Proprietorship

- All income and business expenses belong to the individual
- All of the liability belongs to the individual
- If you have employees, their wages may be a business deduction
- Advice: get a separate Tax ID for your business enterprise

Partnership

- Like a sole proprietorship in that individual partners are responsible for income
- Joint and several liability – ALL are responsible for the liabilities of one

LLC/Inc Offer Limited Liability

- Corporations and Limited Liability Companies offer liability protection
 - Separate entities
 - In order to sue their owners/shareholders, the plaintiff must “pierce the veil” – e.g. show:
 - Inadequate capitalization
 - Alter ego
 - Commingling of funds

LLC v. Corporation

- Equity interest
 - Corporations can have multiple classes of stock
 - S Corporations can have only one class of stock
 - LLCs can have multiple forms of equity interest
- Dividends
 - Corporate dividends distributed pro rata based on ownership (different classes of stock may be treated differently)
 - LLC profits subject to the LLC's management agreement

LLC v. Corporation

- Duration
 - LLC usually exists for fixed period
 - Corporation usually is perpetual
- Management
 - Owners usually manage LLC by default – some states may not permit one member LLCs!
 - Corporate shareholders may have no management duties

Some Reasons to Choose “Inc.” over “LLC”

- LLC ownership limits may limit venture capital opportunities
- Major changes in ownership may terminate a LLC, but may not affect a corporation
- Benefits paid for owners may be treated as taxable income to the owners

Federal Taxes for the DER

- Sole proprietorship
 - Direct tax liability
- Partnership
 - Shared pass-through tax liability
- LLC
 - May elect pass through or corporate tax status on IRS Form 8832
- Corporation
 - May pay taxes separately or elect ‘S’ Corp status

Subchapter 'S' Corp

- Allows certain small companies to elect to be pass-through entities - No double taxation
- Profits and deductions are passed-through to shareholders on a pro rata basis
- Limits imposed on size and negotiability of shares

State Tax Structure for the DER

- Sole proprietorship
 - Direct tax liability
- Partnership
 - Pass-through tax liability
- LLC
 - Pass-through tax liability
- Corporation
 - Corporation is a separate taxable entity

Pass-Through Tax Liability – Simple Example

- Two DERs are partners in an LLC pass-through entity
- They bill \$100,000
- They split the proceeds - \$50,000 each
 - unless there is a written agreement to split the money differently
- Each DER has \$50,000 taxable income
 - Barring an effective contrary written agreement

Corporate Tax – Simple Example

- Two DERs equal owners of a corporation
- Corporation bills \$100,000
- They each take \$45,000 in salary – the remainder is retained by the corporation
 - These amounts can be different!
- Each DER has \$45,000 taxable income
 - Corporation has \$90,000 in salary deductions
 - Remaining \$10,000 is taxable income for company
 - \$10,000 may later be distributed to shareholders, but it is taxable income to them, as well!!!

Thank You for Your Time!

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