Aviation finance and leasing

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Ireland has long been regarded as a leading jurisdiction for aviation finance and leasing. The development of the aviation sector in Ireland can be traced back to the 1970s when the late Dr. Tony Ryan founded Guinness Peat Aviation (GPA) in Shannon, County Clare. Notwithstanding its failed flotation in the early 1990s, GPA played a pivotal role in forging Ireland's reputation as a key – and arguably the pre-eminent – centre of activity in the global aviation finance industry. While other jurisdictions, most notably Malta, Singapore and the Cayman Islands in recent years, have put forward cases to challenge its status, Ireland has continued to improve its offering in a concerted effort, not just to retain its existing businesses, but to compete effectively in the global marketplace.

Ireland's accomplishment is evidenced by the roster of leading industry players who have chosen to operate out of Ireland, including GE Capital Aviation Services (GECAS), Sumitomo Mitsui Banking Corporation (SMBC), International Lease Finance Corporation (ILFC), Ansett Worldwide Aviation Services (AWAS), Avolon, Industrial and Commercial Bank of China Ltd. (ICBC), CIT and Orix. In all, nine of the world's ten largest aircraft leasing companies are located in Ireland and recent figures put the number of aircraft managed in Ireland at 3,500 or 50% of the entire global fleet of leased aircraft. The number of people employed in the industry is estimated at over two thousand (direct and indirect) – many, if not most of them in highly skilled and well paid jobs – and the sector contributes over EUR300 million in corporation tax to the Irish exchequer annually.

So what has contributed to Ireland's phenomenal success and how do jurisdictions such as Malta, Singapore and the Cayman Islands compare? The factors involved are numerous (and in some instances, are shared with other jurisdictions) but include a stable and sophisticated legal system, an "onshore" jurisdiction and a very favourable taxation regime, together with other attractive features, such as membership of the European Union (EU) and the Organisation for Economic Co-operation and Development, a favourable geographic location, and the fact it is an English-speaking jurisdiction with a well-educated workforce boasting many years of experience in the industry.

Legal and regulatory framework

The legal and regulatory framework which exists in Ireland affords the requisite degree of stability, sophistication and user friendliness which, allows aviation industry participants to establish, operate and raise capital with relative ease.

The Irish legal system

Ireland's common law legal system is similar to that of the United Kingdom. However, as a result of its EU membership, Ireland's legal regime is also strongly influenced by EU law. This ensures certain aspects, particularly those involving financial services, are in line with those of other EU member states.

Ireland's legal system allows for numerous options in terms of structuring transactions and facilitating financing across multiple jurisdictions.

Both Irish lawyers and the Irish courts are familiar with the concept of foreign law governed agreements and such agreements will, in most cases, be recognised and enforced by Irish courts. Court judgments and arbitral awards obtained overseas will, again in most cases, be recognised and enforced in Ireland.

Ireland's position as a financial centre of excellence ensures that legal professionals, be they lawyers advising on particular transactions/issues or members of the judiciary adjudicating on disputes involving financing arrangements, have the requisite expertise to deal with complex structures, including those involving cross-border elements and the particular challenges they present.

Clearly however, these factors are not necessarily unique to Ireland. Similarities are discernible, for instance, in the legal and regulatory systems of Malta, Singapore and the Cayman Islands. All three jurisdictions have sophisticated common law based legal systems and Malta is also an EU member state.

Location

Ireland can boast its European credentials but at the same time market its location as bridging the divide between the USA and Europe. Once again, however, Ireland does not necessarily enjoy a monopoly in this regard. The Cayman Islands can also present itself as an ideal neutral jurisdiction in circumstances where transactions involve an international dimension and Cayman Islands law is frequently selected as the governing law for agreements in international transactions. Similarly, both Malta and Singapore claim their locations offer unique advantages. Malta points to its Mediterranean location as a natural hub for European, African and Middle Eastern business activity. Singapore offers clear advantages to those aircraft leasing operations seeking an Asian base, whether because of the increasing demand for commercial aircraft in Asia or the growing strength and significance of Chinese financial institutions. Each would claim an advantage here, but Ireland can point to such recent successes such as attracting a very significant level of business from China, including ICBC's establishment of a major operation in Dublin, and the decision by the Japanese Sumitomo Mitsui Banking Corporation to maintain the headquarters of SMBC Aviation Capital in Dublin after its multi-billion dollar acquisition of the aircraft leasing operation of Royal Bank of Scotland. Ireland's success here is evidence that it is not necessary to be based in Asia to do business there.

The Cape Town Convention

The Cape Town Convention on International Interests in Mobile Equipment (the "Convention") has formed part of Irish law since the enactment of the International Interests in Mobile Equipment (Cape Town Convention) Act, 2005. Ireland was one of the first countries to ratify the Convention and was the first EU member state to do so – underlining the commitment of successive Irish governments to keep Ireland at the leading edge of the industry.

The International Registry of financial interests in aircraft established under the Convention is physically located in Ireland; a recognition by the industry of Ireland's significance in this area.

Ireland's commitment to the Convention is further evidenced by the recent government announcement that it is to amend existing insolvency legislation to enable Ireland to fully comply with the Convention following airline insolvencies.

Both Malta and Singapore are also signatories to the Convention. The Cayman Islands as a British Overseas Territory cannot become a party to the Convention in its own right, (the United Kingdom enacted legislation extending the Convention to the Cayman Islands) but it has however introduced comparable domestic legislation. They cannot however, claim to occupy the central position in relation to the Convention that Ireland can boast and which plays such an important role in aircraft industry related transactions.

No licencing or authorisation requirement

Aviation leasing operations often utilise Irish incorporated private limited liability companies, as they may be incorporated relatively quickly, easily and inexpensively and are not subject to an excessively burdensome or costly compliance regime. The Cayman Islands also offer a relatively efficient and inexpensive incorporation procedure for special purpose vehicles, which similarly have few ongoing administrative formalities.

Moreover, another attraction of Ireland is that Irish companies which own and/or lease aircraft, aircraft engines or helicopters are not obliged to hold a licence from or to be authorised by any state regulatory authority in order to establish or carry on their business.

In both Malta and Singapore operating lease companies are largely unregulated, but both jurisdictions have clear rules and procedures for the registration of aircraft on their respective aircraft registers.

The numerous experienced corporate service providers operating in Ireland ensure that industry participants can set up here with ease and offer a variety of services (such as sourcing suitable Irish individuals to serve as directors for the boards of aircraft holding entities) to ensure compliance with applicable regulatory requirements. Similarly, both Ireland's audit and taxation advisory industries are highly professional and very competitive. Again similarities exist with the Cayman Islands here, which also offer an extensive and experienced financial and legal services sector.

While very few of the aircraft managed in Ireland are ever registered here, registration and deregistration of aircraft in Ireland is a fairly straightforward process. However, Ireland should never be regarded as a "flag of convenience" jurisdiction. The Irish Aviation Authority (IAA) maintains the Irish Aircraft Register here and to register an aircraft with the IAA, the owner or lessor of the aircraft, if a body corporate, must be Irish incorporated and at least two-thirds of its directors must be Irish or EU citizens.

It should also be noted that the maintenance of Irish registered aircraft may be carried out outside Ireland, provided that certain requirements mandated by the IAA are met, including that maintenance be carried out in accordance with an approved aircraft maintenance programme.

Access to capital markets

The combined effect of the reduced availability of traditional bank financing (due to more stringent capital requirements under Basel III and the restrictive lending guidelines prescribed by regulatory authorities), the higher cost of bank financing, the more onerous requirements of bank lenders and the increased demand by "non-traditional" financiers such as private equity houses and the investment funds industry for investment in safe, high quality assets means capital markets have become and will continue to offer a vital form of financing for the aircraft industry.

Accordingly, the importance of Ireland's reputation in this area, which has developed since 1992 when the first aircraft lease securitisation was originated here, as the jurisdiction of choice in terms of establishing special purpose vehicles through which the capital markets may be accessed, cannot be underestimated. The listing of specialist debt securities on the Irish Stock Exchange is relatively inexpensive and time efficient and is employed by both Irish and non-Irish issuers.

That said, Singapore has a similar reputation, particularly in the context of Asian deals, and can point to its own list of newsworthy transactions. Malta would appear to be at a slight disadvantage in this area but between Ireland and Singapore, it is much harder to discern which of the two jurisdictions has the upper hand.

Taxation

Ireland offers a myriad of benefits to aviation industry participants from a taxation perspective and in particular offers favourable corporation tax, withholding tax, stamp duty and VAT treatment. The Finance Act 2013 introduced new measures designed to further incentivise the growth of Ireland's aircraft leasing industry.

Corporation tax

Various types of taxation vehicles can be established in Ireland, each offering differing benefits to the various players in the aviation industry:

Trading company

Trading profits are taxed at the lower rate of corporate tax of 12.5% in circumstances where leasing activities are sufficient to constitute "a trade". Although in many cases the particular leasing activities will constitute a "trade" for taxation purposes, this term is not specifically defined and as such, each case must be assessed in light of guidance issued by the Irish Revenue Commissioners and case law.

In addition, a deduction of expenses of a revenue nature incurred "wholly and exclusively" for the purpose of the trade applies to revenues generated by the trade. In addition, capital allowances (ie tax depreciation) are generally available to a trading lessor at an annual rate of 12.5% in respect of capital expenditure incurred on the acquisition of an aircraft for the leasing trade (subject to certain conditions, including the burden of wear and tear remaining with the lessor). Furthermore, the Finance Act 2013 provided for the introduction of accelerated tax depreciation for the construction of hangar and other ancillary aviation facilities with a view to enhancing and expanding Ireland's current aviation industry offering, in particular into the maintenance, repair or overhaul (MRO) space.

Non-trading company

Where the lessor's activities do not constitute a "trade" for Irish taxation purposes, a taxation rate of 25% will apply to profits generated by the lessor's activities, but a deduction is generally available for most expenses. This rate of taxation often applies in cases of lease in/lease out transactions where profits, calculated by subtracting the head lease income from the sub-lease income, tend to be minimal.

A qualifying company

Section 110 of the Tax Consolidation Act 1997 forms the basis of Ireland's favourable structured finance and securitisation regime. Following amendments to the legislation in 2011, plant and machinery, including aircraft and aircraft parts, now also constitute "qualifying assets" which may be held by "qualifying companies". As a result, aircraft leasing transactions (and transactions involving the securitisation of lease receivables) can be structured so as to employ "qualifying companies" to achieve tax neutrality.

Withholding tax

Outbound lease payments

Lease rental payments are not subject to withholding tax in Ireland and as such, out-bound lease payments may be made free of withholding tax.

Inbound lease payments

Unilateral credit relief is available for withholding tax incurred on lease rentals where the benefit of a double taxation agreement with Ireland is not available.

Dividends paid by an Irish resident company are, in the ordinary course, subject to withholding tax (DWT) at a rate of 20%. However, Irish tax law provides for numerous exemptions from DWT including where the payments are made to recipients in an EU member state or recipients in a country with which Ireland has a double taxation agreement, subject to certain conditions and requirements being satisfied (eg a relevant non-resident declaration is required to be completed by the recipient). Ireland has also implemented into domestic tax law the provisions of the EU Parent/Subsidiary Directive which allow dividend payments to be made by a subsidiary company to its parent company free of DWT without the need for completion of a non-resident declaration.

Similarly, interest payments are, in the ordinary course, subject to a withholding tax at a rate of 20%. However, much like the treatment of DWT, exemptions are available, subject to certain conditions being met, notably where payments are made to a recipient in an EU member state or a country which has entered a double taxation agreement with Ireland.

Double taxation agreements mitigate the taxation of income in the country where the income was generated and the country of residence of the beneficiary of the revenue and as such, incentivise businesses to engage in international transactions. Ireland has an extensive network of double taxation agreements (the majority of which provide for 0% withholding tax on lease related payments) with sixty nine countries, including all EU member states, the USA, China, Japan, Russia and Singapore and negotiations are on-going with Jordan, Tunisia and Azerbaijan to put such agreements in place.

Stamp duty

Stamp duty is a tax which is generally payable in respect of instruments which operate to transfer property. However, under Irish law, instruments which operate to sell, transfer or otherwise dispose, either absolutely or otherwise, of any aircraft or any aircraft part, interest, share or property in an aircraft are expressly exempt from stamp duty.

Additionally, the Finance Act 2013 introduced an exemption from stamp duty on the issue, transfer or redemption of an enhanced equipment trust certificate (which is a type of debt instrument that is issued by a company in order to raise finance for the acquisition, development or leasing of aircraft).

Value Added Tax (VAT)

Ireland, in common with all other EU member states, operates a system of VAT. However, while VAT will always need to be addressed on any leasing transaction, Irish VAT law provides that in the context of international aircraft leasing, no VAT applies on lease rentals, with full VAT recovery (input VAT recovery) being available on costs attributable to the leasing activities.

How do the others compare? Malta's headline corporate tax rate is higher (at 35%) but Malta operates a refundable tax credit system, so the effective rate can drop to as low as 5%. Singapore has a headline rate of 17% but under its Aircraft Leasing Scheme incentive, the applicable rate on qualifying income can drop to 10% or even 5%. Both Malta and Singapore have similar stamp tax (stamp duty) regimes to Ireland. Malta's VAT regime is (unsurprisingly, given it is an EU inspired tax) similar to Ireland's while Singapore's VAT equivalent, its Goods and Services Tax (GST), in many cases zero rates activities associated with aircraft leasing. Both jurisdictions take a similar approach to Ireland on withholding taxes but neither has as extensive a network of double tax treaties as Ireland, with Singapore's coming closer than Malta's. Neither Malta nor Singapore is an OECD member. Clearly Ireland, Malta and Singapore can, to varying degrees, boast of offering a favourable tax environment in which to operate but in reality they cannot match the Cayman Islands in terms of its status as a tax-neutral jurisdiction - currently no income tax, corporate tax or capital gains tax and no withholding tax is imposed in the Cayman Islands on any cash flows. Consequently, Ireland cannot depend on taxation alone as a means of maintaining its competitive advantage in this area.

Other Advantages

While Ireland's attractiveness to the leading players in the aircraft leasing and finance market undoubtedly stems largely from its favourable legal framework and taxation regime, a variety of other factors also serve to give Ireland a competitive edge in this global market.

Ireland prides itself in its hospitality and Irish people are naturally welcoming and open. Ireland has a long tradition of emigration and large Irish communities exist in many influential nations around the world. These communities maintain strong ties with Ireland, both culturally and economically. Historical ties with the USA are particularly noteworthy in this respect. These ties often make it attractive for foreign companies to do business in Ireland.

A highly educated, skilled and English-speaking workforce is also a key factor in attracting foreign companies to locate here. More specifically, some forty years of experience in the field of aviation finance has allowed Ireland to develop exemplary commercial, financial and technical know-how and Ireland can boast a large selection of quality service providers, including lawyers, accountants, corporate service providers and tax advisors in the aircraft leasing and finance markets. Moreover, demand amongst workers for experience in this field, consequently increasing their expertise and attractiveness for industry players, is demonstrated by the recent introduction by leading educational institutions of tailored courses. Although there are, without doubt, highly skilled people and organisations in all of these fields in Malta, Singapore and the Cayman Islands, it is arguable that the pool of talent Ireland offers is substantially larger and we can point to a well established reputation of excellence in this area.

Future prospects

This industry – as any of its participants will confirm – is famously competitive, so standing still is not an option. Against that backdrop, what does the future hold? Like many other jurisdictions that are actively developing their presence in the aircraft finance market, Ireland is constantly striving to maintain its leading role in the industry.

The Irish government has implemented a variety of well-targeted legislative changes which are especially apparent in the area of taxation. For instance, the Finance Act 2012 included a number of measures beneficial to the aircraft finance sector including the Special Assignee Relief Programme which, in broad terms and subject to certain conditions being satisfied, provides income tax breaks to key executives employed in the aircraft finance industry in Ireland.

Ireland's most recent budget included further incentives for the development of the sector, including accelerated tax depreciation for the construction of hangar and other ancillary aviation facilities – clearly designed to spur Ireland's growth as a centre for aircraft maintenance and warehousing – and as outlined above, an exemption from stamp duty on the issue, transfer or redemption of an enhanced equipment trust certificate.

The unique combination of extensive industry experience acquired over 40 years, an adaptable and highly skilled workforce, a stable sophisticated legal system, an attractive taxation regime and a strong domestic political commitment to supporting sustained growth in the industry has ensured Ireland's attractiveness to many industries, but perhaps none more so than the aviation industry. The continued presence of those factors will ensure Ireland's position as a leading player in this sector will continue for the foreseeable future. Undoubtedly however, in light of the competition offered by other jurisdictions in this field, Ireland must maintain and, arguably, increase its efforts not just to win new business but to retain that valuable business it already has.

END NOTES:

This information is for information purposes only and does not purport to represent legal and/or tax advice. Neither author is qualified to advise on matters of Maltese or Singaporean law or tax.

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September 2011, Issue 219
ARCHIVE LINK offshoreinvestment.com/archive