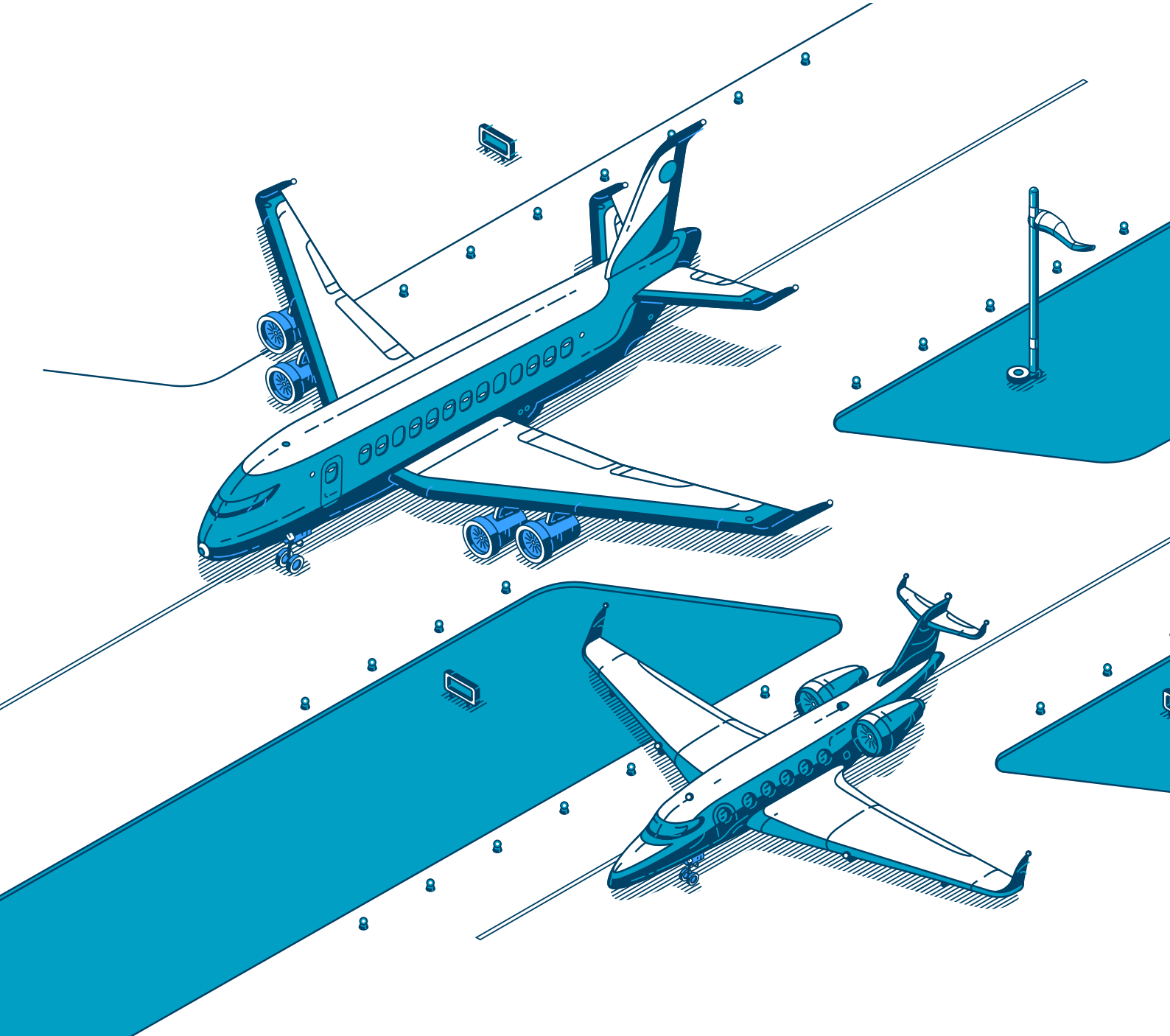
India Aircraft Leasing Summit 2021: Rupee Raftaar

Knowledge Paper

Developments in the Regulatory Framework for Aircraft Leasing and Financing in India



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List of Abbreviations

AIF	Alternative Investment Funds
Aircraft Rules	Aircraft Rules, 1937
Cape Town Convention	Cape Town Convention on International Interests in Mobile Equipment
Cape Town Convention Bill	Cape Town Convention Bill, 2018
DGCA	Directorate General of Civil Aviation
FATF	Financial Action Task Force
GIC	Global In-House Centre
GIFT City	Gujarat International Finance-Tec City
GST	Goods and Services Tax
IBC	Insolvency and Bankruptcy Code, 2016
IDERA	Irrevocable Deregistration and Export Request Authorization
IFSC	International Finance Services Centre
IFSCA Act	International Financial Services Centres Authority Act, 2019
IFSC Authority	International Financial Services Centres Authority
IGST	Integrated Goods and Services Tax
INR	Indian Rupees
IRDAI	Insurance Regulatory and Development Authority of India
Protocol	Protocol to the Convention on Matters Specific to Aircraft Equipment
RBI	Reserve Bank of India
SEBI	Securities and Exchange Board of India
SEZ	Special Economic Zones - GIFT City and other IFSC are deemed to be SEZ
WHT	Withholding tax



Introduction

India is emerging as a major hub for aviation in the world. The Indian aviation industry has grown tremendously over the last few years, on the back of a strong domestic demand, expansion of low-cost carriers, growth in cross border trade and private investment and development of airport infrastructure. The International Air Transport Association forecasts India to become the third-largest aviation market in terms of passengers by 2025.

It is in this context that the Government of India recognizes the potential for developing an industry for aircraft leasing and financing in India involving institutional investors, as stated in the Union Budget speech 2019-20. Globally, aircraft leasing and financing business is undertaken from international financial centers that offer a competitive regulatory framework and economic incentives to support the high value asset leasing and financing business. The Government has identified the IFSC at GIFT City in Gujarat, which has an offshore status for financial services, as a viable platform to provide a favorable legal and regulatory regime and host a globally competitive aircraft leasing and financing hub in India.

This Knowledge Paper highlights the recent legal and regulatory reforms enabling aircraft leasing activity in India and the benefits of transacting out of the IFSC in GIFT City as compared to the global market leader Ireland. These recent changes have removed several bottlenecks to initiating aircraft leasing business and provide various tax incentives, competitive financing options, ease of compliance and a framework to implement globally used efficient structures.

It is hoped that the proposed exemptions and incentives would help in creating an attractive ecosystem for aircraft leasing and financing in India.



Updates to the Legal and Regulatory Framework

1. IFSCA Act and IFSC Authority

The IFSCA Act was notified on 19 December 2019 and by notification dated 27 April 2020, the Ministry of Finance established the IFSC Authority to regulate the financial products, financial services or financial institutions in the IFSC. All powers exercisable by financial sector regulators, RBI, SEBI, IRDAI, etc. under various legislations have been vested upon the IFSC Authority pursuant to the IFSCA Act in so far as it relates to the regulation of the financial products, financial services or financial institutions in an IFSC.

2. Aircraft leasing as financial product

By notification dated 16 October 2020, the Central Government notified aircraft leasing (including operating and financial lease and lease of aircraft/ helicopters/ engines or any other part) as a financial product under the IFSCA Act that financial institutions are permitted to undertake from an IFSC.

3. Framework for undertaking Aircraft Operating Lease business in IFSC

By way of a circular dated 19 February 2021, the IFSC Authority has notified a framework for enabling aircraft lessors to undertake: (i) operating lease for an aircraft lease arrangement including sale and lease back, purchase, novation, transfer, assignment, and such other similar transactions in relation to aircraft lease; and (ii) any other related activity with the prior approval of the IFSC Authority.

An entity may apply to the IFSC Authority for registration as an aircraft lessor in the IFSC if it satisfies the specified eligibility criteria including: (a) person in control of the lessor should be located in a FATF compliant jurisdiction; and (b) maintaining minimum capital requirement of USD 200,000 or its equivalent freely convertible currency at all times along with complying with other prudential norms to be prescribed by the IFSC Authority.

Lessors are permitted to transact in freely convertible foreign currency only, except for administrative expenses that may be defrayed in INR by maintaining a separate INR account. A lessor may be required to maintain additional capital based on the size and scale of its operations.

4. Banking units in IFSC permitted to undertake aircraft leasing activities

The IFSC Authority (Banking) Regulations, 2020 issued on 18 November 2020 permit Indian and foreign banks to apply to the IFSC Authority for license to set up banking units in IFSC. Minimum capital of USD 20,000,000 (or such other amounts as determined by IFSC Authority) is required to be maintained on an unimpaired basis and a no objection letter from the bank's home regulator is also required.

The regulations also set out the permissible activities of IFSC banking units including credit enhancement, credit insurance, and sale, purchase of portfolios, engage in factoring and forfaiting of export receivables and undertaking equipment leasing, including aircraft leasing. Such entities are also permitted to undertake investments, including subscribing, acquiring, holding, or transferring securities of other IFSC units.

5. Direct tax incentives available to aircraft leasing units in IFSC

- 100% tax exemption for any 10 consecutive years out of 15 years for setting up of a unit in IFSC.
- No MAT applicable to IFSC entity opting for new tax regime (i.e. opting for a concessional income tax rate of 22% (plus applicable surcharge and cess) provided prescribed exemptions/ deductions are not availed. This would mean an effective NIL tax rate during the tax holiday period.
- From 1 April 2020, dividend income distributed by Indian companies (including those in IFSC) is taxed in the hands of the shareholders (and not the company). This has resulted in lowering the overall tax burden, as non-resident shareholders are able to access lower treaty rates and avail credit of Indian taxes.
- Tax exemption is provided on interest income earned by non-residents from IFSC units for monies borrowed by such IFSC units on or after 1 September 2019.

6. Indirect tax incentives available to aircraft leasing units in IFSC

No GST on goods or services, (i) received inside the premises of the unit in SEZ (including IFSC) for authorised operations; and (ii) provided to SEZ units (including IFSC), subject to specified conditions.

7. Stamp Duty

The Government of Gujarat has waived the stamp duty on all instruments executed in the state of Gujarat in relation to aircraft/ aircraft engine/ helicopter leasing, its financing and refinancing or its insurance and reinsurance in or from Multi Service Special Economic Zones, including IFSC at GIFT City for a period of 10 years commencing from 4 August 2020.

8. Tax Proposals in the Union Budget Speech of 2021-22

The following tax exemptions and incentives (subject to conditions) were announced in the Union Budget of 2021-22:

- Tax holiday applicable to capital gains arising to an IFSC unit on transfer of an aircraft or aircraft engine which was leased by it to a domestic company engaged in the business of operation of aircraft prior to such transfer - in other words, no capital gains tax if an aircraft or aircraft engine is disposed during tax holiday period; and

- Tax exemption for royalty income of a non-resident on account of lease of an aircraft to an IFSC unit.



India v Ireland

Below is a comparison between the tax regime in Ireland (currently a major hub for aircraft leasing and financing in the world) and the regime in India.

Particulars	India IFSC	Ireland
Corporate Tax	100% tax exemption for any 10 consecutive years out of 15 years for setting up of a unit in an IFSC After tax holiday period, 22% plus surcharge and cess (in case new tax regime is adopted)	12.5% (however, group consolidation allowed)
Minimum Alternate Tax for lessor company	Under MAT provisions, where tax on total income of a company is less than 9% (including units in IFSC) on adjusted book profits, MAT @ 9% (plus applicable surcharge and cess) on adjusted book profits is payable. However, MAT is not applicable to IFSC units opting for concessional income tax rate of 22% provided specified exemptions/ deductions are not availed. This would mean an effective NIL tax rate during the tax holiday period if the 22% tax regime is followed.	Not applicable

Particulars	India IFSC	Ireland
Tax Depreciation Allowance	Allowed to depreciate the aircraft for MAT computation over 20 years	Allowed to depreciate the aircraft cost over 8 years
Interest expense on aircraft loan/ intercompany funding	Deductible on arms' length payments	Deductible on arms' length payments
WHT on interest payment by lessor company	Interest to domestic parties: 10% Interest to non-residents: Typically, 10/15%% in tax treaties Exempt if paid by IFSC units to non-residents for monies borrowed on or after 1 September 2019	20% (exemption available to payments to 'Qualifying lender') Typically, would be 'zero' WHT
WHT - lease rental paid to lessor by airline	2%	Nil
WHT - lease rental paid by IFSC lessor to upstream owner (if any)	Exempt (proposed)	Not applicable
GST on lease rental payments by Indian airline operator	5%	5%
Taxable base	Gross Rentals less deductible expenses including depreciation allowance. May result in no taxation under normal regime; and if new regime is opted then no MAT applicable (for the duration of tax holiday)	Gross Rentals less deductible expenses including depreciation allowance. No taxation since significant tax depreciation allowance available
Disposal of aircraft	Currently, being a depreciable asset, capital gains will be subject to tax at the applicable corporate tax rate (22% - 30% plus surcharge and cess) As per Budget 2021, capital gains will be subsumed within the tax holiday. GST will be applicable at 5% on prescribed value. Export benefits may be available, where exported	Taxable as income to the extent of the original cost and excess gains taxable as capital gains.
Stamp Duty	Nil	Nil

9. Attracting different classes of investors

Recent regulatory changes have also liberalized fund raising alternatives for aircraft lessors established in an IFSC including from non-banks, AIFs, Indian high net worth individuals (HNIs), mutual funds and overseas investors:

- Foreign Exchange Management (IFSC) Regulations, 2015 recognize 'non-banking financial companies' as a category of companies that may set up operations in IFSC as a financial institution.

- SEBI liberalised the investment norms for AIFs operating in the IFSC. AIFs in IFSC have been exempted from restrictions limiting investment of more than 25% of the investable funds in one investee company (as otherwise applicable under the SEBI (AIF) Regulations, 2012).

- By way of RBI notification on 16 February 2021, resident individuals have been permitted to make remittances under the Liberalized Remittance Scheme for making investments in IFSCs securities with the approval of authorized dealer banks. This will enable high net worth individuals to diversify their portfolio and invest in aircraft leasing entities.

- To facilitate external borrowings by units located in an IFSC, tax exemption is provided on interest income earned by non-residents from units located in an IFSC. The exemption is applicable with respect to monies borrowed by units located in an IFSC on or after 1 September 2019.

- Mutual funds and AIFs are permitted to establish units in the IFSC and also invest in the securities listed in IFSC and securities issued by companies incorporated in IFSC. Pursuant to Finance Act, 2019, tax exemption was granted to unitholders on distributions by specified mutual funds on income from transactions on a recognised stock exchange in an IFSC. Specified mutual funds include mutual funds, (a) located in an IFSC; (b) deriving income solely in convertible foreign exchange; and (c) all units of which are held by non-residents.

- Transactions in the IFSC are primarily conducted in freely convertible foreign currencies. However, pursuant to the Foreign Exchange Management (IFSC) Regulations, 2015 amended on 7 January 2020, provide that financial institutions in the IFSC may with general or special permission of RBI also conduct business in INR.

10. Other miscellaneous updates

Some other recent regulatory changes that are likely to benefit the development of an aircraft financing industry in India are discussed below:

- Through notification dated 16 October 2020, Central Government notified GICs as financial service to provide services relating to financial products and other financial services under the IFSCA Act subject to the eligibility criteria. GICs provide support services to non-resident entities for the purpose of carrying out financial services with respect to a financial product. GICs are service delivery operations owned and operated by the same company receiving the services which may be located in a different jurisdiction. GICs serve as offshore back-

end processing centres for the parent company. Considering, aircraft leasing has been added as financial product under the IFSCA Act, GICs of global aircraft leasing entities or related financial services situated in FATF compliant jurisdictions could be established in IFSC.

- Insurance intermediary offices (i.e. insurance brokers, corporate agent, surveyor and loss assessor, etc.) are permitted to operate from IFSC.

- Singapore International Arbitration Centre has a representative office at the GIFT IFSC to facilitate a neutral and independent dispute resolution platform to international and domestic parties undertaking large international transactions from GIFT IFSC.

- No GST on:
  - transactions carried out in IFSC exchanges;
  - services received by unit in IFSC; and
  - services provided to IFSC/ SEZ units or offshore clients.

- Exemptions from securities transaction tax, commodity transaction tax and stamp duty in respect of transactions carried out on IFSC exchanges.

- Foreign Exchange Management (Export of Goods and Services) Regulations, 2015 were amended by RBI on 8 January 2021 to provide exemption from filing of Export Declaration Form for re- export of leased aircraft (either completely or in partially knocked down condition) re-possessed by overseas lessor and duly de-registered by the DGCA on the request of IDERA holder under Cape Town Convention or any other termination or cancellation of the lease agreement between the lessor and lessee (subject to permission by DGCA/ Ministry of Civil Aviation for such export).



The Way Forward

1. Enactment of the Cape Town Convention Bill, 2018

India is a signatory to the Cape Town Convention and the Protocol, the international treaties that aim to achieve efficient financing of high-value mobile equipment like aircrafts, helicopters and engines by creating a universally applicable legal regime. India ratified the Cape Town Convention in 2008. Certain provisions of the Aircraft Rules relating to deregistration and export of aircraft have been brought in line with the Cape Town Convention, however there is a need for a separate legislation to fully implement the treaty.

Currently there are inconsistencies between the provisions of the Cape Town Convention and the Protocol which grant the right of repossession of an aircraft to creditors or lessors after the expiry of a waiting period of 60 days if defaults under the lease or financing agreements remain unsettled, and the IBC that provides for a 180 day moratorium period (extended further by 90 days) during which any enforcement of security or repossession of aircraft/ aviation equipment by creditors or lessors could be restricted.

In this regard, the Government had proposed the Cape Town Convention Bill in 2018 which is currently undergoing further modifications and is expected to be introduced soon. Once enacted, the Cape Town Convention Bill will ensure full implementation of, and give overriding effect to provisions of the Cape Town Convention and the Protocol.

A specific statute would provide confidence to creditors and reduce the risks associated with asset-based financing and leasing transactions, which in turn would reduce the cost of aviation credit and benefit the aviation industry and also passengers through price reductions.

2. Exemption from custom duties

- **Exemption from Customs duties/ import IGST on import of aircraft by aircraft leasing company in SEZ:** Customs duties and import IGST are exempt for goods or services imported by a unit in SEZ for authorized operations. However, there is ambiguity in the SEZ regulations which could be strictly interpreted to mean that an aircraft leasing company needs to import the aircraft physically within the SEZ area to avail such exemption (where the leasing company is the importer on record, as opposed to the airline operator; or where the aircraft is purchased while it is located within India). Thus, SEZ legislations may be suitably amended/ clarified to dispense with the requirement to physically import the aircraft within the SEZ premises.

- **Exemption from Customs duties on import of aircraft by a lessee operator under a lease agreement with an IFSC lessor:** There are certain basic custom duties and IGST exemptions already available in case of lease by domestic airline entity. However, certain conditions in the IGST exemption are based on the premise that the lessor is situated outside India. Such conditions may either be technically difficult to fulfil or may lead to litigious situations down the line in case the lessor is also an Indian entity (whether in IFSC or otherwise). These conditions may be relaxed / revisited where the imports by the lessee operator are under a lease agreement with an Indian (IFSC) lessor.

3. Other tax incentives:

- Removal of requirement of withholding tax on lease rentals paid by airline companies to aircraft leasing companies located in IFSC.

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