

PROJECT RUPEE RAFTAAR: AN ANALYSIS

Background

The Working Group on Developing Avenues for Aircraft Financing and Leasing Activities in India, constituted by Ministry of Civil Aviation submitted its report¹ on measures for developing this industry in the country. The Working Group was formed to examine the regulatory framework relating to financing and leasing of aircrafts. The idea was derived from the Cape Town convention and it has also been proposed to enact a bill in order to fully implement the convention. This project is based on the theme "Flying for All". The Indian civil aviation market has been exhibiting tremendous growth for past years. There is an overwhelming increase in demand for passenger transportation for which airlines in India have placed orders for more than 1000 aircrafts. Moreover, Indian airlines have been relying on other countries for financing acquisition of aircrafts on export credit, loan or lease basis. This hair-triggers the need for India to have in place its own systems for financing of such acquisitions.

One of the motivations of the project is to ensure that the dependence of Indian aviation industry on import leases is reduced. Currently more than 90% of the aircrafts operating in the country are on import lease basis, and there is a huge monthly outflow of foreign exchange by way of lease rentals, which is not reported as ECB, since it is an operating expense.

Global perspective to aircraft financing and leasing

The key players in global aircraft financing and leasing market are Ireland and the US. Countries like China, Singapore, Hong Kong and Japan are emerging competitors in the market. The structures of aircraft financing, however, differ largely in all of these countries. The overall trends in the global arena can be evaluated on following bases:

Regional Outlook: through a research conducted for the Aviation Industry Leaders Report², it was concluded that North America is viewed as the most optimistic market player. Europe shows mixed signals due to market being strong and simultaneous slowing down of economy and other political issues. The Middle Eastern countries show a slow pace of growth and their models exhibit signs of stress. African airline market still has a lot of unrealised potential.

Financing Trends: sale and lease back transactions have become the most frequently used medium of aircraft finance over the world. Other forms of financing such as commercial bank debt, pre-delivering payment financing etc. have picked up pace. Also, traditional forms of financing such as export credit continue to be in operation but with reducing levels. Overall, the capital market remains very active and innovative in the aircraft finance sector.

Technology: new technology in aircrafts is being introduced frequently. However, implementation and commercialisation of the same continues to be a challenge. The Aviation Working Group's Global

¹ <https://www.globalaviationsummit.in/documents/PROJECTRUPEERAFTAAR.pdf>

² <https://assets.kpmg/content/dam/kpmg/ie/pdf/2019/01/ie-aviation-industry-leaders-report-2019.pdf>

Aircraft Trading System (GATS) proposed digitisation of transfer of lease deed ownership system which shall be expected to be activated by end of the year 2019.

Current scenario of Aircraft financing in India

In terms of growth and advancement, India is far behind other Asian economies such as China, Singapore and Hong Kong. However, the Indian Aviation market has shown exponential rise in the past few years with an annual growth rate of 18.86% in 2017-18 and overall growth of 16.08% in passenger traffic. From 74 operational airports in 2013, it has reached a height of 101 operational airports in 2016. Expectations of having 190-200 operational airports by the end of 2040 are pointed out through various studies.

Currently, India has large aircraft order books, virtually all of which are leased through leasing companies located offshore. Under the regional connectivity scheme Ude Desh ka Aam Nagrik (UDAN), the government has decided to lease out operations, maintenance, and development of certain airports under Public private Partnership (PPP) model.

Overall, India has immense potential for growth in aviation sector but little means to aid the growth. It is in need of systems that aid the growth in a cost-effective and sustainable manner.

Aircraft financing structure

Why is it needed?

In the view of increasing demand and non-availability of own sources of aircraft financing, it is essential for India to set up its own structures for the same. Moreover, civil aviation sector is an important sector for development of the economy. In the civil aviation industry, aircraft financing is the most profitable segment and there are no entities in the country exploring this line of business. All the benefits from this gap are being enjoyed by foreign entities.

What will be the structure?

For this structure, GIFT-CITY in Gujarat has been identified as preferred destination for initiation of operations in this industry as it offers a tax regime competitive to that of leasing companies all over the world.



Barriers in the structure

The aforementioned structure will face following barriers:

- GAAR prevents Indian financiers from taking advantage of other jurisdictions.
- Aircraft financing is not a specifically permitted activity for banks.
- Units operating in GIFT-CITY not permitted to undertake aircraft financing.
- Framework for setting-up of NBFCs in GIFT-CITY and provisions as to treatment of income from operating lease is not provided.
- Taxes and duties:
 - GST of 5% on import of aircraft
 - GST on lease rentals
 - Interest amount which forms part of lease rentals in case of financial lease is not eligible for any tax benefit.
 - No exemptions from withholding taxes
 - Stamp duty on instruments and documents executed.

The working group has proposed corresponding changes and amendments to be made to overcome these barriers. The response of relevant authorities is awaited.

Tax implications of the structure

Particulars	Tax rates	
	IFSC-GIFT CITY (proposed structure)	INDIA (not following the structure)
INCOME TAX		
Corporate Tax Rate:		
○ Year 1 to 5	0.00	34.94
○ Year 6 to 10	17.47	
○ Year 11 onwards	34.94	
Minimum Alternate Tax	10.48	21.55
Capital gains on sale of aircraft	0.00	34.94
Withholding tax		
○ Operating lease rentals	0.00	2.00
○ Interest payment (USD debt)	0.00	5.46
○ Interest payment (INR debt)	0.00	0.00
○ Other payments	0.00	10.00
Dividend Distribution Tax	nil	20.56
GOODS AND SERVICES TAX		
Purchase of aircraft	0.00	0.00
Operating lease rentals	0.00	5.00
Underfinance lease(interest portion)	0.00	5.00
Other services	nil	18.00

Stamp duty on lease related documents	0.00	3.00
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Analysis of tax implications under various modes of financing

Following table shows an analysis of indirect tax implications from the point of view of lessee and compares the proposed structure with the existing practice of financing as well as situation if financing is done outside the proposed structure but in India.

This table is based on following assumptions:

- Value of aircraft- Rs.3500 crores
- Residual value- Rs.500 crores
- Rate of interest- 7.5%
- Lease tenure- 25 years

Tax expenditure	Ireland	IFSC-GIFT CITY	Rest of India
GST on lease rentals	15.3315	0.00	15.3315
Stamp duty	0.00	0.00	105
GST on other services	0.00	nil	12.6
Overall indirect tax expenditure	15.3315	0.00	27.9315

- Processing fee- 2%

On the aforesaid assumptions, lease rental per annum would amount to Rs.306.63 crores

Amount (in Rs. crores)

Overcoming the barriers

Recommendations have been made by the Working Group to various regulatory authorities in order to overcome various barriers that are a hindrance to establishment of India's own structure of aircraft financing and leasing. Following table shows some of the major recommendations:

Authority	Recommendations
RBI	Confirm that the term "equipment" includes aircrafts or notify aircraft financing and leasing as permitted activity for banks or subsidiaries of banks.
	Amend IBU circular to include equipment leasing and investment in capital of leasing entities in scope of activities of banks
	Confirm that equipment leasing entities shall be eligible to register as NBFC in IFSC
	Issue specific directions in regard to investment in or by foreign entities engaged in aircraft financing and leasing activities.
Tax authorities	Capital gains on sale of leased aircrafts should be fully exempted.
	GST on leasing aircraft should be made zero-rated.
	Nil withholding tax should be specified for airline companies.
	Transfer/novation of aircraft financing / leasing contracts to units in an IFSC should not be under the purview of GAAR, for both the lessee and lessor
SEBI	Amend SEBI (AIF) Regulations to create a separate category of AIFs for investment in aircraft financing/leasing activities or permit greater concentration of investment in aircraft financing/leasing entities.
	Clarify whether 25% investment cap by AIFs applies on investment in equipment and grant additional relaxations to AIFs investing in aircraft financing activities.

	Create separate category of mutual funds of investment in entities engaged in aircraft financing and leasing activities.
	Clarify which institution can invest in entities registered in IFSC.
IRDAI	Amend IRDAI regulations permitting companies set up in IFSC to invest in entities engaged in aircraft financing and leasing activities.
	Clarify whether investment of funds of policyholders' in entities registered in IFSC be considered as funds invested in India only.
Others	Clarify under aircraft rules that aircrafts of lessors cannot be detained against any statutory or other outstanding dues.
	Entities like pension funds, insurance companies, employee provident fund organisations be allowed to invest directly or indirectly in aircraft financing and leasing activities.
	SARFAESI Act not be applicable to aircrafts.
	Gujarat Stamp Act to exempt aircraft financing and leasing from its purview.
	Permit airlines to set up branch in IFSC.

Conclusion

It is absolutely evident that aircraft industry is on upsurge and will continue to be rising globally in the coming years. To meet the rising demand and expand the country's hold in the aviation market the proposed structure provides a well-established groundwork through the proposed structure. All recommendations, if accepted and implemented in a proper manner, will enable India to pioneer a very profitable and growth-oriented aviation market.