

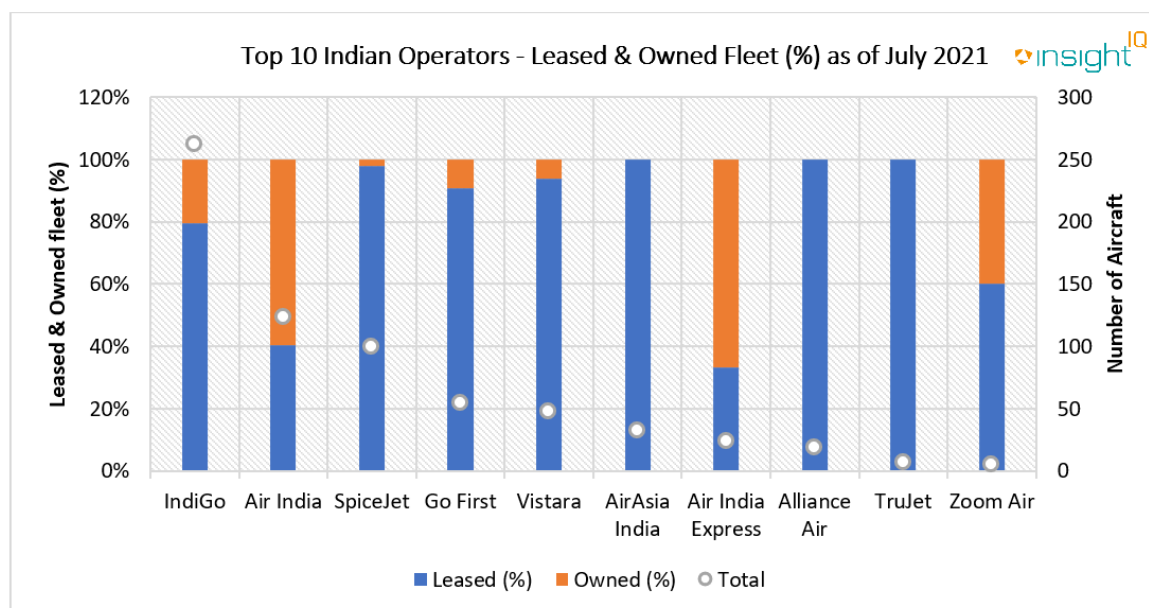
Aircraft leasing in IFSC

FUELED BY INCENTIVES, READY TO TAKE OFF

Introduction

India is the 7th largest civil aviation market in the world and is set to become the world's 3rd largest by 2026 as per International Air Transport Association (IATA) forecasts. This is backed by strong growth in passenger traffic due to rising income and low-cost air travel. As per the IEBF Report for August 2021¹ India is projected to have 480 million flyers by 2036, which will be more than that of Japan (just under 225 million) and Germany (just over 200 million) combined. Naturally, this will lead to an increase in demand for more aircrafts and their spares to support the rising demand for air travel.

Airlines, all over the world, prefer leasing an aircraft instead of purchasing one as it provides flexibility in operations. As per the report submitted by the Working Group, constituted by the Ministry of Civil Aviation (MoCA), in 2018, titled 'Project Rupee Raftaar: Development of Aircraft Financing & Leasing in India', over 70% of the aircraft acquisitions in India, in the last decade, have been on an operating lease basis and the trend is expected to continue in the future. This is much higher as compared to 46% prevailing globally. The chart² below shows that the top 10 carriers in India are leasing approximately 80% of their fleets on average as of July 2021. This figure has remained consistent in the past five years, and despite the notable leasing trend, there appears to be no major commercial aircraft leasing company based in India, thus creating a vacuum. Consequently, all the benefits from this gap are being enjoyed by foreign players.



Source: InsightIQ

¹ <https://www.ibef.org/download/Aviation-August-2021.pdf>

² [Aviation Intelligence – India's First Gift City Leasing Company](#)

To change the status quo and to develop a self-reliant aviation industry, India has set up an International Financial Service Centre (IFSC) in Gujarat i.e. Gujarat International Finance Tec-City (GIFT).



Through this write-up, we have tried to explain what is IFSC and its scope of activities, regulatory aspects applicable for aircraft leasing transactions in IFSC along with the relaxations given to the entities set up in an IFSC.

What is IFSC?

IFSC is a designated area, wherein financial entities can be set up for providing various financial services to persons across borders. They help the Indian corporates with easier access to global financial markets and to complement and promote further development of financial markets in India. The intention is to provide ease of operations, business-friendly regulations, and regulatory and tax incentives that are at par with international jurisdictions. IFSCs are, therefore, governed by a separate regulator (i.e. IFSC Authority) empowered under the IFSC Authority Act, 2019 which replaces all the Financial Sector regulators namely the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority of India (IRDAI) and Pension Fund Regulatory and Development Authority (PFRDA).

The GIFT IFSC supports a gamut of financial services, *inter-alia*, banking, insurance, asset management, and other financial market activities. Figure 1.1 below lists down the market participants in IFSC and various financial services provided by them.

Market participants	Financial Services	Financial Products
<ul style="list-style-type: none"> Financial institutions engaged in rendering financial services in respect of any financial product. These institutions can be: <ul style="list-style-type: none"> Banks, NBFCs, Insurance companies, Stock Exchanges, Clearing Corporations Depositories, Brokers, Investment Advisers, Alternative Investment Funds, Mutual Funds, etc. 	<ul style="list-style-type: none"> Buying, selling, or subscribing to a financial product; Acceptance of deposits; Administering/managing financial products; Effecting contracts of insurance; Operating an investment scheme; Underwriting a financial product; Providing information about a person's financial standing; Providing payment services; Making arrangements for undertaking above activities; Other service, if any, notified by Central Government (CG); 	<ul style="list-style-type: none"> Securities; Contracts of insurance; Deposits; Credit arrangements; Foreign currency contracts other than contracts settled immediately w.r.t. exchange of one currency for another; Other product or instrument as may be notified by that may be notified by CG. (As stated earlier, 'Aircraft lease' has been notified as a financial product vide Notification dated October 16, 2020.)

Figure 1.1

Benefits of setting up a unit in IFSC:

IFSC is treated as a foreign jurisdiction. This means any service rendered from an IFSC will be treated as an export.

A unit set up in IFSC is considered as a person resident outside India for exchange control purposes.

Various tax incentives including exemption from Capital Gains Tax on disposal of aircrafts, waiver of stamp duty etc.

Regulatory relaxations combined with competitive cost of operations increases the ease of doing business in IFSC.

Resolution of disputes through representative office of Singapore International Arbitration Centre.

State-of-the-art infrastructure at par with other global financial centres.

Integrated ecosystem of banks, insurance, capital markets, law firms and consultancy firms.

Extensive Double Tax Treaty Network with more than 90 jurisdictions

Additionally, aircraft financing and leasing through IFSC will have the following advantages:

Strong demand for aircrafts due to rise in air travel

Support from Government by way of various incentives and exemptions

Light touch regulations in a robust framework

Engagement with a forward looking, proactive and unified regulator i.e. IFSC Authority

Ease in executing transactions since parties are 'at home'. Helps in providing quick maintenance, repair and overhaul (MRO) facilities thereby developing the MRO industry.

Availability of an integrated ecosystem of services like insurance, fund raising, banking, advisory, global in-house centres (GICs) (which has been notified as a financial service).

GICs will help the lessor to set up entities for providing delivery and servicing operations in cost effective and timely manner.

Aircraft leasing – flow of events

May 2018:	Setting up of Working Group (WG) by MoCA a) To develop an economy for aircraft leasing and financing in India b) WG held over 40 sessions with all stakeholders c) Consolidation of tax and regulatory aspects
Jan 2019:	Rupee Raftaar Report a) First step in setting up initial framework on aircraft leasing & financing. b) Multiple meetings to gain insights about aircraft leasing & financing dynamics
July 2019:	FM Budget speech 2019-20: Provided tax incentives to IFSC on aircraft financing and leasing
Apr 2020:	Establishment of IFSC Authority to regulate all financial services in IFSC in India.
Sept 2020:	Ministry of Civil Aviation Circular dated September 2, 2020 Clarification that Project Rupee Raftaar covers both fixed wing aircrafts (<i>i.e. airplanes</i>) and rotatory wing aircrafts (<i>i.e. helicopter</i>), irrespective of the nature of air transportation services to be provided by a potential lessee / lessor from IFSC.
Oct 2020:	Finance ministry notifies 'Aircraft lease' as a financial product that could be transacted in IFSC.
Dec 2020:	IFSCA issued consultation paper on proposed Aircraft leasing regulations.
Feb 2021:	Tax incentives announced in Union Budget 2021 for aircraft leasing & financing transaction carried out from IFSC.
Feb 2021:	Regulations for establishment of aircraft leasing units in IFSC at GIFT-City India notified by IFSCA.
Mar 2021:	Finance Act 2021: Clarification and tax reliefs for aircraft leasing transactions in IFSC.
May 2022:	Framework for Aircraft leases issued by IFSCA
April 2023:	Leasing of Aviation training simulation devices enabled
Sept 2023:	First Aircraft leasing for IFSC takes place. TDS exemption for dividend paid by one IFSC unit to another engaged in aircraft leasing.

Structure for Aircraft leasing

As is known, accounting standards distinguish between financial and operating leases. In the context of aircrafts, wet lease and dry lease are terms very commonly used. Wet leases typically provide crew, maintenance etc. in addition to the right to use the aircraft.

The financial lease-operating lease distinction is more of an accounting issue; in fact, accounting standards also, over time [see IFRS 16], have tried to eliminate the difference. From a legal perspective, a lease is a lease, and it should not matter whether it is a financial or operating lease. In the context of aircraft leasing, the popular global jurisdictions may or may not distinguish between financial or operating leases.

In Singapore commercial law a finance lease is defined as a contractual arrangement where the owner leases goods to usually one hirer (who pays rent for the use of the goods) for the estimated working life of the goods. Unlike a hire-purchase, no option to purchase is conferred upon the hirer by the lease agreement. Thus, a conventional operating lease (wherein the property in the leased goods

never passes to the lessee) is covered within the scope of a financial lease under the commercial law of Singapore.

Apart from Singapore, even the Irish commercial law also does not make any distinction between an operating and a financial lease. On the other hand, a perusal of the laws pertaining to Dubai Financial Services Centre (“DFSC”) indicate that only financial leases are recognized as financial products in the DFSC. However, the term ‘financial lease’ is not defined further and therefore it is not clear if the same includes an operational lease.

The IFSCA framework³ in India provides that ‘Aircraft Lease’ includes operating and financial lease and any hybrid of operating and financial lease of aircraft or helicopter and engines of aircraft or helicopter or any other part thereof.

An aircraft lease (whether operating or finance lease) is commonly given effect through a Sale-and-Leaseback model (SLB), wherein an airline acquires the aircraft, sells the same to the lessor and leases it back for its own use. The SLB model provides a method of financing, frees up equity tied in the aircraft (for the lessee) and is also beneficial for the purpose of controlling tax consequences, and is, therefore, the preferred model when it comes to aircraft financing.



Eligible entities for registration in IFSC:

Finance Companies

These are financial institutions engaged in rendering financial services⁴ in respect of any financial product⁶ **separately incorporated** to deal in one or more of permissible activities, one of which is aircraft leasing.

It shall not:

- accept public deposit from resident & non-resident; and
- be registered with IFSC Authority as a Banking Unit.

Finance Units

These are financial institutions engaged in rendering financial services⁶ in respect of any financial product⁶ **set up as a branch** to deal in one or more of the permissible activities, one of which is aircraft leasing.

It shall not:

- accept public deposit from resident & non-resident; and
- be registered with IFSC Authority as a Banking Unit.

³ <https://ifsc.gov.in/Document/Legal/framework-for-aircraft-lease22072022072247.pdf>

⁴ See Fig. 1.1 for the list of financial services and financial products.

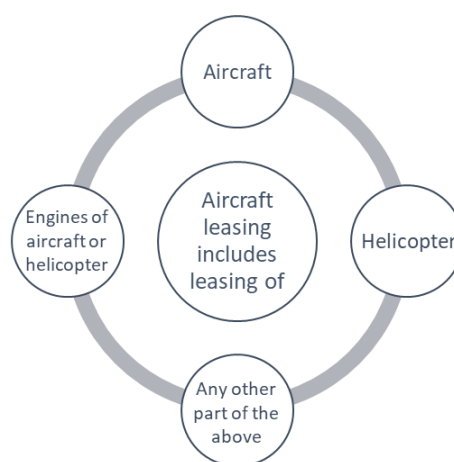
Can be set up either as a subsidiary or JV or as a newly incorporated company.
In case the investing entity is carrying out a regulated financial activity in its home jurisdiction & should have obtained the No-Objection Certificate (NOC) from its home country regulator for setting up a Finance Company in IFSC.

The ultimate parent / investing entity of the Finance Unit should be carrying out a regulated financial activity in its home jurisdiction & should have obtained the NOC from its home country regulator for setting up a Finance Unit in IFSC.

Eligible leasing activities:

Both financial lease transactions and operating lease transactions have been permitted for aircraft leasing in IFSC. While financial lease has been classified as “permitted core activity”, operating lease comes under “permitted non-core activity”. The minimum capital to be maintained by an eligible entity is based on its classification into core or non-core activity.

As only a Finance Company or a Finance Unit *i.e. financial institutions* can get registered in IFSC, both financial and operating lease transactions can only be entered into by financial institutions. Compared to the domestic scenario, any company, which intends to carry out financial leasing as its principal business activity, has to be RBI-registered. While a company carrying out operating lease as its principal business has no such requirement.



Aircraft Operating lease arrangement

It can be in the form of:

- ▶ sale and lease back
- ▶ purchase
- ▶ novation
- ▶ transfer
- ▶ assignment other similar transactions
- ▶ other related activity with prior approval of IFSC Authority

Currency for conducting business:

- ▶ Any freely convertible foreign currency.
- ▶ Administrative expenses may be in INR by maintaining a separate INR account.
- ▶ Financial information shall be submitted to IFSC Authority in USD unless otherwise specified.

Eligibility criteria for lessors:

- (i) Entity shall be set up as a Company or LLP or Trust or other form as IFSCA may specify.
- (ii) The person(s) in control shall be in FATF compliant jurisdiction.
- (iii) Minimum Capital requirement (discussed below) shall be complied with at all times.
- (iv) Obtain registration from IFSC Authority – by applying in the format given in the [Framework for Aircraft Operating Lease](#).

Reporting requirements:

Following information shall be furnished to IFSCA within 15 days of finalisation of annual financial statements:

- Annual financial statements.
- Confirmation of compliance with:
 - Regulations, circulars, etc. issued by IFSCA.
 - Capital requirement and details thereof.

- Details of material regulatory action, if any, against the entity or persons(s) in control.

In case of financial leasing, the entity cannot be set up as a LLP or a Trust since it comes under permitted core activity.

Minimum Capital Requirements

Unless the prescribed minimum owned funds are maintained, the entities cannot commence business as a Finance Company or Finance Unit in IFSC. In case of a Finance Unit, the requirement shall be fulfilled by its parent entity. The requirement for an entity engaged in aircraft leasing transactions is as follows:

No.	Activity	Minimum Owned Fund Requirement
1	Undertaking only operating lease transactions for aircraft lease <i>(Classified as Permitted Non-core Activity)</i>	USD 0.2 million or equivalent freely convertible currency <i>(IFSCA may prescribe maintenance of additional capital as a risk management measure)</i>
2	Undertaking one or more core activities with or without non-core activities. <i>(Financial lease transaction for aircraft lease is classified as Permitted Core Activity)</i>	USD 3 million or equivalent amount in any other freely convertible currency.

Coming to the domestic scenario, the minimum net owned fund required to be maintained by a NBFC, carrying out financial leasing as its principal business activity, for obtaining registration is Rs. 25 lakhs. There is no such requirement for entities carrying out operating leasing activities as a principal business.

The regulations further state that aircraft lease transactions shall be in conformity to the [Cape Town Convention and Protocol](#)⁵. India has been one of the signatories of the Cape Town Convention and Protocol since 2008.

Objective:

- To reduce risks for creditors, and consequently, the borrowing costs to debtors, through improved legal certainty.
- Promoting granting of credit for acquisition of more modern and fuel-efficient aircrafts.

International Registry

It provides for the creation of an International Registry for recording of international interests in aircrafts objects along with information relating to defaults in payments, remedies, insolvency proceedings, title, aircraft deregistration etc.

Aircraft objects means airframes, aircraft engines and helicopters.

Remedy for creditors in cases of defaults:

- Take possession or control of the aircraft objects charged to it;
- Sell or grant a lease any of the above *(give reasonable prior notice in writing to the interested persons)*;
- De-register the aircraft;

⁵ Find our article [<https://vinodkothari.com/2023/06/goair-insolvency-lessors-rights-gone-in-thin-air/>]

- Initiate export and physical transfer of the aircraft object from the territory in which it is situated;
- Collect or receive any income or profits arising from the management or use of any such object.

Tax incentives for IFSC units

In order to encourage the growth of IFSC in India, various tax incentives have been provided to units set up in IFSC as enumerated below:

Direct Tax benefits:

1. Tax holiday

A Tax Holiday for any 10 consecutive years, at the option of the assessee entity, out of the first 15 years of its operations shall be given for units set up in IFSC. Separate tax holidays shall be taken for each transaction for each SPV as group consolidation is not allowed.

2. Minimum Alternate Tax (MAT)

Companies are liable to pay MAT on their adjusted book profits where the tax liability under the normal provisions is not more than 15% of such book profits. The rate of MAT is 15% (plus surcharge and cess). For IFSC units, this rate is 9% where income is solely in convertible foreign exchange.

Post the tax holiday, companies in the IFSC can avail the concessional tax rate of 22% (plus surcharge and cess) (i.e. new tax regime wherein MAT has been made inapplicable). As the new tax regime is not applicable to a foreign company including its branches, units of such foreign companies set up in IFSC shall have to follow the old tax regime and can avail benefit of reduced MAT rate of 9%.

3. No Withholding Tax (WHT)

WHT simply means holding back a certain amount of the receiver's income in the form of tax and paying it to the Government. No WHT is required on interest paid to non-residents by units in IFSC. This makes debt funding for aircraft leasing activity lucrative.

Further, effective April 1, 2022, no WHT would be required on aircraft lease payments in the nature of royalty paid to non-residents by units in IFSC that commence operations on or before March 31, 2024.

4. Non-taxability of interest and leasing income received by non-residents from IFSC units

As mentioned above, no WHT is required on interest paid to non-residents by IFSC units. This Interest income arising to a non-resident lender for monies borrowed from it by an IFSC unit is also exempted from tax in India. Thus, any interest from an IFSC unit received by a non-resident lender would not be taxable in India.

Similarly, effective April 1, 2022, aircraft leasing income in the nature of royalty from an IFSC unit received by a non-resident lessor would not be taxable in India.

5. Depreciation

Depreciation on aircraft and aircraft engines allowed at 40% Written Down Value (WDV) basis. Further, unabsorbed depreciation can be carried forward indefinitely.

6. Capital gain on transfer of aircraft

Effective April 1, 2022, capital gains arising from transfer of aircraft or aircraft engine would be eligible for a 100% profit-linked deduction (i.e. tax holiday).

7. Dividend received by parent from subsidiary in the IFSC

Till April 1, 2020, an Indian company was required to deduct DDT while distributing dividend and it was not taxable to the shareholders. However, DDT was not applicable to units in IFSC. With effect from April 1, 2020, DDT has been abolished, and a company paying dividends to its shareholders is required to withhold tax. Tax rate for non-residents in case of domestic jurisdiction is 20% while for offshore units, the applicable rate is 10%.

Indirect Tax benefits:

1. Import of goods/services into the IFSC

- No basic custom duty (BCD) on import of goods (which includes aircraft / aircraft engine) into IFSC.
- No GST on leasing of aircraft / aircraft engine or services provided within IFSC or offshore clients if the services are procured for authorised operations.

2. Leasing by Indian airlines from an Indian lessor in IFSC

- No BCD on import of aircraft / aircraft engine by an Indian airline from an Indian lessor in the IFSC for scheduled air operations.
- Leasing of aircraft / aircraft engine by an Indian lessor in IFSC to an Indian airline is subject to IGST @ 5% under forward charge (it is on reverse charge in case of foreign lessors).

Stamp Duty

A unit in the IFSC, engaged in the aircraft leasing business, has been granted a waiver from payment of stamp duty on all activities related to setting up of units in IFSC and acquisition of any movable property (including aircraft) or immovable property for a period of 10 years commencing from August 4, 2020. However, this waiver may not be available on the stamp duty arising on the sale of an aircraft.

Through these initiatives, the Government has provided a much-needed push to IFSC and brought it on par with the leading financial centres. A comparative analysis of tax structure in major aircraft leasing centres, in table⁶ below, shows that India has reached the level of other leading jurisdictions in terms of incentives if not already ahead.

Particulars	India (in the IFSC)*	Ireland	Hong Kong	China	Singapore
Corporate tax rate	100% tax exemption for 10 consecutive years out of 15 years. (however, no group loss relief transfers available)	12.5% (group loss relief transfers available)	16.5% (reduced to 8.25% for qualifying aircraft leasing and leasing management companies)	25%	17% (reduced to 8% for income derived from aircraft leasing activities [group loss relief transfers available])

⁶ [Aircraft leasing in India: Ready to take off](#)

Particulars	India (in the IFSC)*	Ireland	Hong Kong	China	Singapore
MAT for lessor company	Nil – if opting for the new tax regime, else 9%	Not applicable	Not applicable	Not applicable	Not applicable
Dividend to shareholders of company	Taxable to shareholders For non-residents – 20% (lower tax treaty rate can be applied) For residents – 25-40%	Nil (certain cases taxable at 25%)	Nil	10%	Nil
Tax depreciation allowance	40% at WDV Almost entire value is depreciated over 8 years.	Allowed to depreciate the aircraft cost over 8 years.	Not applicable	Allowed to depreciate the aircraft cost less residual value over 10 years.	Can depreciate the aircraft over any number of years from 5–20 years.
WHT on interest payment by lessor	Nil	20% (exemption available to payments to ‘qualifying lender’); typically would be ‘zero’ WHT.	Nil	10% (maybe reduced by applicable tax treaty)	Nil
WHT on lease rental paid to lessor	Indian entity to IFSC lessor – 2% IFSC lessee to foreign entity (paid as royalty) – nil**	Nil	10%	10%	10%
Taxable base	Gross rentals less deductible expenses, including depreciation allowance Generally, no cash tax liability in early years since significant tax depreciation allowance is available	Gross lease rentals less deductible expenses, including depreciation allowance Generally, no cash tax liability in early years (prolonged for leasing platforms with particular levels of growth) since significant tax depreciation allowance available	20% (gross lease rentals less allowable expenses, excluding depreciation) Effective tax rate – ~3%– 7%	Gross lease rentals less deductible expenses, including depreciation allowance	Gross lease rentals less deductible expenses, including depreciation allowance Generally, no cash tax liability in early years (prolonged for leasing platforms with particular levels of growth) since significant tax depreciation allowance available

Particulars	India (in the IFSC)*	Ireland	Hong Kong	China	Singapore
Disposal of aircraft	Capital gains on disposal of aircraft leased to an Indian company eligible for 100% deduction provided that the IFSC unit has commenced operations on or before March 31, 2024**	Taxable as business income to the extent of the original cost claimed as tax depreciation. Excess gain may be taxed as trading profits at 12.5% depending on the facts (33% capital gains tax applicable in certain circumstances).	Not subject to tax on aircraft disposal after 3 years.	Capital gains is taxed as part of operating income at 25%.	Taxable as business income to the extent of the original cost claimed as tax depreciation. Excess gain may not be subject to tax on disposal if the gain is regarded as capital in nature (17% tax applies if any gain is regarded as revenue in nature).
GST on lease rental payments by Indian airlines	5%	5%	5%	5%	5%
Stamp duty	Nil	Nil	Nil	0.1 - 0.005% depending on nature of lease arrangement	Nil

* The above tax rates are exclusive of applicable surcharge and cess.

**The above tax proposals shall be subject to the tax holiday period available to the IFSC unit. Further, these proposals have been introduced in the Finance Act, 2021.

State of the market

It is [reported](#) that Air India's financial lease of A350-900 marks the beginning of lease transactions from IFSC. Indigo is also reported to have set up a leasing entity.

Adani group is [reported to have formed](#) Udanvat Leasing IFSC for leasing aircrafts too.

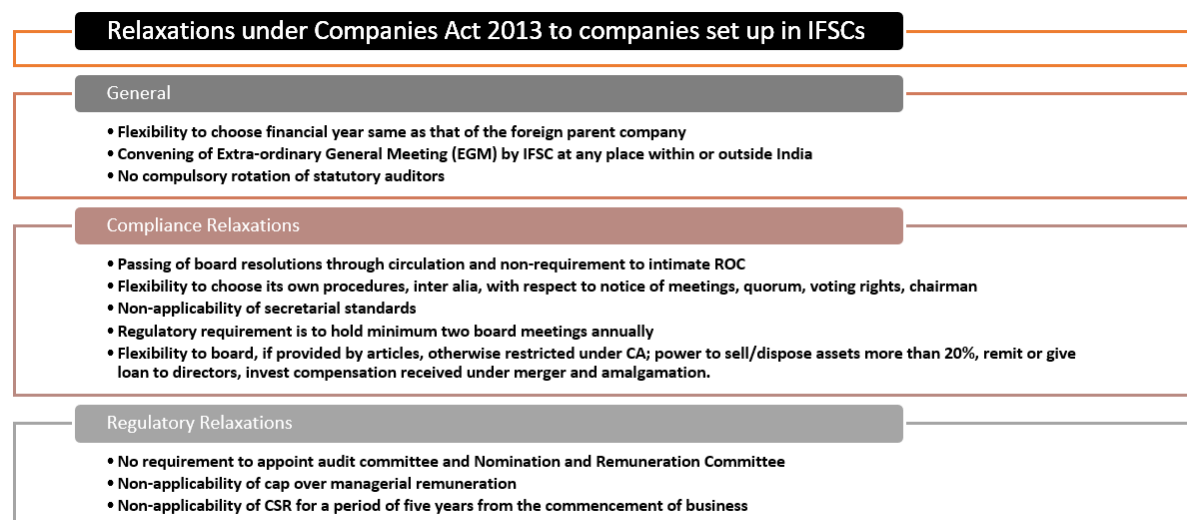


Figure 1.4

Conclusion

There is a huge dependence that Indian airlines have, on lease of imported aircrafts. This was the concern with which IFSC was conceptualised⁷. Though it has taken nearly 5 years to gather traction, it seems that finally, there will be aircrafts acquired and leased from IFSC to Indian airline operators.

⁷ Vinod Kothari was a part of the working group called [Project Rupee Raftaar](#).