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Aircraft Leasing

The Finance (No.2) Act 2023 contained a number changes that aim to give clarity around areas including capital allowances and the calculation of profits for both lessors and lessees. Can you outline the changes and the implications for aircraft leasing companies operating from Ireland?

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Ted O'Byrne, Tax Consultant, Maples Group: This article highlights recent Irish tax changes relevant to the aviation leasing industry. The Irish aviation leasing industry has grown to the point that an Irish-leased aircraft takes off from a runway around the world every two seconds. Ireland's attractiveness to investors can be attributed to a competitive tax regime, a comprehensive double tax treaty network as well as its skilled workforce within the financial services sector. Any tax changes are significant and will impact this complex ecosystem.

The first change to highlight is not entirely legislative. It is a change in Irish Revenue practice. Traditionally, Irish aviation lessors would seek to obtain the benefits of Ireland's 12.5% trading tax rate. Trading presupposes there is some activity conducted in Ireland and a trading model involves employees, office space and key economic decisions and actions being located in Ireland. However, one of the features of aviation, is the use of "special purpose vehicles" which would only undertake a small number of functions. There are companies which may hold a single aircraft on lease, or which would be used to provide funding to other group companies. Such structures are common to facilitate bank lending and isolate risk. Historically, Irish Revenue would accept that each such entity was trading, provided it was part of an active trading group. However there has been a gradual change in approach from Irish Revenue. The trading status of such entities must now be much more closely scrutinised with the role of entity, it's resources and activity levels being judged on a standalone basis. If there is not sufficient activity then the entity will not be trading. It will be taxed under Ireland's less favourable corporate tax rules for passive income and taxed at 25%.

Entities which are just involved in a single lease should consider their treatment. In particular, if the active management of the lease is outsourced to a third party, such as an Irish based servicer, there is a need to clearly demonstrate that this servicer is under the control of the board, and that the board has a high level of involvement in the activities.

Where an entity is used as a group finance company, there appears to be a clear intention to remove trading status from such entities if they do not have sufficient activity. The most recent Irish Finance Act (Finance (No.2) Act 2023 (the "Act")) introduces a new concept of a "Qualifying Financing Company". This provides for specific tax treatment (and therefore certainty) for companies engaged in intra-group financing. However, interest deductibility limited to third party debt and a number of other conditions must be met. This has led to significant restructuring requirements for groups which had relied on tax advice which was based on the old practice-based approach.

The Act introduces other legislative changes. Firstly, in relation to finance leases, there has been a change which impacts historic treatment. Previously, Irish Revenue allowed finance lessors to be taxed on their finance margin, rather than their gross revenue, where the lessee claims capital allowances (tax depreciation) on the aircraft. The Act puts this treatment on a statutory footing. The Act introduces additional changes relating to spreading of revenue evenly over the life of the lease irrespective of the accounting treatment. All of these changes could impact existing groups and structures and require some level of review as they will likely be questioned as part of an annual audit for 2024.

The major alternative to trading structures is the Irish “section 110 regime”, which is so called because of section 110 of the Irish Taxes Consolidation Act 1997 which it operated under. Although the treatment of section 110 companies is currently part of the general review of the taxation of Irish investment products, the model has remained unaffected by the recent changes for aviation lessors. While subject to its own specific anti-avoidance provisions, it remains a viable option for lessors who do not have substance.

The Act also introduced new Irish withholding tax measures on payments of dividends, royalties and interest payments to zero tax jurisdictions or EU non-cooperative jurisdictions where those payments are made to associated entities. This has particular relevance for aviation structures where an ultimate holding company can be based in such a jurisdiction.

Finally, the Act has also transposed the EU Global Minimum Tax rules into Irish domestic law. This may have implications for some of the larger leasing structures as it applies to entities and groups with more than EUR750 million of annual revenues. This can result in the imposition of a minimum tax rate of 15% on certain groups.

Overall, lessors should be consulting with their advisors on these changes and where appropriate, considering the potential impact and where appropriate, restructuring to mitigate unwanted effects. Ireland remains an excellent jurisdiction within which to base aircraft leasing platforms, however, it has taken steps to legislate for initiatives such as the Global Minimum Tax and to remove certain historic practices in an effort to sustain the regime for the coming decades.

Finally, and by way of note, the implementation of the Pillar Two minimum effective rate from 2024 is another development that will have to be carefully considered by those companies falling within the scope of Pillar Two. In particular, those companies claiming the PDE will need to consider how such dividends are assessed and treated under the Pillar Two rules.