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Aviation Sector – Beyond 2022

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Aviation Sector – Beyond 2022

There is an old curse which says *"May you live in interesting times."* Since 2020, the aviation community have been living in 'interesting times' and in a time of unprecedented uncertainty. The COVID-19 global pandemic is now largely behind us, but we are facing other uncertainties – environmentally, economically and geo-politically. In times of crisis, business participants seek out established markets; robust structures and credit arrangements and secure and stable legal regimes for certainty and security of outcomes. Ireland is such a location for the aviation sector.

In this note, we look at some of the legal, regulatory and tax landscape in Ireland for aviation business including lenders, investors and companies in 2022 and beyond. We prepared this note to:

- Spotlight the EU sanctions that have recently been put in place in response to Russia's actions in Ukraine
- Highlight the extension of COVID-19 legislative measures and the end of transitional arrangements to 31 December 2022 in Ireland
- Identify sources of finance and reform in funding structures relevant to the aviation sector
- Outline regulatory and reporting requirements, and
- Identify new corporate arrangements and reforms underway in 2022/2023 which may impact on transaction participants in the areas of company law, compliance, governance and oversight, and tax

Sanctions

In response to Russia's invasion of the Ukraine, the European Union quickly revised sanctions regulations and included specific measures which directly affect the aviation sector. Council Regulation (EU) 2022/328, amends Regulation (EU) No 833/2014, which introduced an export ban covering goods and technology suited for use in aviation and the space industry to any natural or legal person, entity or body in Russia or for use in Russia.

The Regulation sets out other prohibitions in respect of insurance / reinsurance, inspection or repair services, technical assistance or financing in respect of goods and technology suited for use in aviation or the space industry. For leased aircraft, the sanctions are aimed at denying access to vital spare parts, remove access to insurance and accelerate enforcement actions by lessors and financiers.

In more recent developments, EU Council Regulation 2022/576 of 8th April 2022 provided for a limited derogation for national authorities to authorise certain actions relating to aircraft financial leases concluded before 26 February 2022 and additional new measures on the provision of fiduciary, management and corporate services to Russian nationals and legal entities. A sixth package of sanctions is expected in the near future.

There is no clarity on how long sanctions will remain or continue and we will continue to closely monitor Irish, EU and international developments.

COVID – Will it linger?

The Companies (Miscellaneous Provision (COVID-19) Act 2020 (the COVID Act) came into effect on 21 August 2020 to address some of the practical issues related to COVID 19. It was extended on 28 April until 31 December 2022.

Summary of key COVID Act measures are:

1. Continuation of virtual general meetings
2. Threshold at which a company is deemed unable to pay its debts remains at €50,000
3. Extension of time to 150 days to facilitate company rescue remains until 31 December 2022. In Ireland, examinership is available as a protective remedy for companies. The COVID Act gave the Court power to extend a period of protection from creditor action by up to 50 days, beyond the previous maximum 100 day limit. CityJet, an Irish airline, successfully exited a period of examinership in the late Autumn of 2020

Importance of Alternative Sources of Funding

What to Expect in 2022/2023

Traditional commercial bank lending has been impacted by COVID-19, at least in the short term. Alternative providers of finance stepped in to fill the funding gap. Private funds, investment funds and private equity investors play a key role as sources of alternative funding and many of the larger private equity firms currently hold strategic investments in the aviation sector. The appetite of investors depends on a number of criteria, including legal structures, tax regime, distribution channels and internal charters.

Investment Funds

There are a number of investment funds based aircraft financing solutions in Ireland. Qualifying investor alternative investment fund (QIAIF) can be deployed and used for investment strategy focused on aviation. Funds can be applied singularly or in combination with Irish Section 110 company. A Section 110 company holds and/or manages 'qualifying assets' such as aircraft and is generally regarded as a central part of Ireland's structured finance regime, permitting achievement of a neutral tax position provided certain conditions are met. The preferred legal structure of the QIAIF deploying an aviation strategy is either an Investment Limited Partnership (ILP) or Irish collective asset-management vehicle (ICAV).

Investment Limited Partnerships

Recognising the potential in alternative lending sources for business, Ireland introduced modernising legislation relating to ILPs in 2021.

Investment Limited Partnership (Amendment) Act 2020 (ILP Act) commenced in February 2021. It modernises Ireland's regulatory framework for ILPs and offers a structuring solution for private equity, private credit, real asset, infrastructure and other private fund strategies and has scope to make Ireland the domicile of choice for the establishment of private funds. The legislation brought Ireland's ILP structures into line with comparable partnership vehicles in other leading jurisdictions, and this is hugely important to the aviation sector.

The ILP as a QIAIF is a regulated fund vehicle, regulated by the Central Bank of Ireland (CBI). Amongst the key benefits are:

- Suitability for US managers seeking to raise capital in the EU and which can then be distributed to professional investors throughout the EU using the marketing passport
- Umbrella ILPs – that are divided into compartments of sub-funds with segregated liability which can be established
- Tax transparent vehicle
- Benefits of using hosted AIFM for regulatory compliance and EU expertise

- General partner is not regulated, save that directors must comply with CBI fitness and probity regime
- Migration of ILPs – the ILP Act provides a statutory process to facilitate the migration of partnerships registered in certain recognised jurisdictions to Ireland by way of continuation

ICAV

ICAV is a corporate vehicle and is also widely used in investment strategies. ICAVs are subject to the same attractive Irish tax regime that currently applies to companies. ICAV's are able to elect its classification under the US check-the-box taxation rules which can be helpful to US investors in investment funds. It allows investors in ICAVs to be subject to US tax as if they held the underlying assets in the fund directly.

Capital Markets and ABS

Recent trends show strong investor confidence in aviation ABS issuance sector and product, notwithstanding the unprecedented COVID-19 challenges. The aviation asset-backed securities (ABS) market had a strong return in 2021 with a total of fourteen reported debt issuances totalling $8.5 billion.

We expect the Aviation ABS market to be tapped again in 2022. Investors have been opting for conservative financial and legal structures and using tried and tested structures involving Ireland as a key jurisdiction due to legal, structural, regulatory and tax attractiveness.

In March 2021, Euroclear Bank, an International Central Securities Depository, succeeded CREST, which is operated by Euroclear UK & Ireland, in the provision of securities settlement services for securities constituted under the laws of Ireland. It is a recognised third country Consignment Security Declaration (CSD) in accordance with Article 25 of EU's Central Securities Depository Regulation ((EU) No. 909/2014) (CSDR). Moving forward, Irish debt securities can use Euroclear Bank's Irish CSD services which provides Irish issuers a 'unique' pathway into the Euroclear CSD, with much greater scale and connectivity in comparison to other EU domestic CSD.

From an Irish debt capital markets/ issuer perspective, this enhances the jurisdictional attractiveness of issuing debt securities using Irish special purpose vehicles. The Euroclear pathway combines well with the fact that:

1. The Irish Stock Exchange (which trades as Euronext Dublin and is a member of the Euronext group), is recognised as a leading debt listing venue worldwide, and
2. Ireland's position as a leading European jurisdiction for the incorporation of special purpose vehicles.

Company Law Reform

Foreign Investment Screening is coming to Ireland

In September 2020, the Government agreed to draft legislation which will give effect to the EU regulation 2019/452 to screen foreign direct investment (FDI) coming into Ireland. The text of the bill has not yet been published.

The new screening process has potential impact for some aviation business, particularly those involved in areas of security and defence.

We anticipate that the new screening legislation will apply to a broad range of investments which establish or maintain lasting and direct links between investors from 3rd countries and undertakings carrying out an economic activity in Ireland, excluding portfolio investment. The screening process which is to be conducted by the office of the Department of Enterprise, Trade and Employment will permit, block, or permit with conditions future FDI transactions in categories, but full detail and extent of its application is yet to be provided.

The new Corporate Enforcement Authority

The Companies (Corporate Enforcement Authority) Act 2021 (CEA Act) was signed into law on 22 December 2021. Although not yet commenced, it allows for the transition the ODCE into an independent statutory agency – the Corporate Enforcement Authority or CEA - with additional resources to investigate and prosecute white collar crime.

Tax & Reporting Provisions for Aircraft Leasing Companies

What to Expect in 2022/2023

Tax planning and structuring is key to aviation sector corporate planning, financial products and aviation leasing and management services. We outline below a summary of key tax provisions in Ireland.

Corporation Tax

A standard corporation tax rate of 12.5% continues to apply to trading companies. The rate is set to increase to 15% for firms with global consolidated revenues of €750 million or more, as a result of the Irish Government signing up to the OECD's global deal on corporate tax reform. Groups which have revenues below this level will not be subject to the new rate and therefore most structures will be unaffected by the change. The timing of the introduction of the new rate is not certain but could be implemented as early as 2023.

Anti-Tax Avoidance Directive (ATAD) and other measures

- New interest limitation rules came into effect for accounting periods commencing on or after 1 January 2022. Ireland was required to introduce these rules under the EU's ATAD.

  The new rules will restrict the level of interest deductions which may be claimed by Irish companies and will be relevant to many groups in the aviation sector who will need to assess the impact on their current structures. The interest restriction only applies to the extent that interest equivalent expense exceeds interest equivalent income. Helpfully, the Irish rules recognise that a portion of an aircraft operating lease rental is equivalent to interest income. This means that a lessor can reduce its net interest expense by this amount for the purpose of applying the restriction which should reduce or eliminate the impact of the new rules for some lessors. In addition, no restriction should apply for a company where the total net interest expense in a given year does not exceed €3 million.
- Finance Act 2021 introduced some further amendments to Irish tax rules with potential consequences on leasing structures. Notably, reverse anti-hybrid rules were introduced, and changes made to the existing anti-hybrid rules. These rules were introduced as a result of the EU ATAD rules and therefore are also a feature in other countries. The rules aim to address situations where there is a mismatch between the tax treatment of entities or instruments in different countries. One example is where a mismatch results in a situation where a tax deduction is claimed in one jurisdiction, but the income is not taxed in the other country.

Tax residency

Irish Revenue issued guidance in 2020 allowing directors to attend board meetings remotely while COVID-19 travel restrictions were in place, without it affecting the company's tax residence. This followed OECD guidance which recognised COVID-19 is an extraordinary situation and should not trigger a change in residency. A similar concession applied where employees of a foreign entity were based in Ireland during the pandemic. Employee presence should not create a taxable presence for the employer where employees were based in Ireland during the pandemic.

These Irish Revenue concessions expired on 1 February 2022. If not already in hand, Corporate Groups should review their internal operating policies and practices to ensure the required substance and management is in Ireland for companies which are intended to be Irish resident. They should consider the impact of continuing with any temporary arrangements to facilitate employees of non-Irish companies who were based in Ireland during the pandemic.

Double Tax Treaties

The Multilateral Instrument (MLI), which modifies the application of the majority of Ireland's Double Tax Agreements entered into force on 1 May 2019. One of the changes introduced into tax treaties by the MLI was the Principal Purpose Test (PPT), which denies the availability of treaty relief from withholding tax in cases where it is reasonable to conclude that a tax benefit was one of the principal reasons for entering into the arrangement (so called 'treaty shopping'). This is an issue for Irish entities in receipt of income, including lease rental income and is of particular relevance to LILO structures. The MLI also introduced changes to the permanent establishment rules which expand the circumstances where activity in a particular country could trigger corporation tax obligations. While Ireland did not sign up to all of the changes, there is increased international focus on the issue and many lessors will be reviewing impact and consequence of the MLI in Ireland and customer locations.

Restructurings and rationalisations

We expect to see further group restructurings and simplifications over the next year across all sectors. Ireland has a well-developed tax framework which allows assets and undertakings to move within a corporate group with minimal or no tax leakage. Helpfully, the Finance Act 2021 included a change which helps to simplify the tax treatment on a domestic merger by absorption.

DAC 6

The EU is focused on increasing the level of tax transparency across all member states and EU Council Directive on Administrative Cooperation (DAC6) introduced an EU wide mandatory disclosure regime for cross-border arrangements that bear certain "hallmarks" as set-out in the directive. The provisions of the regime came into effect from 1 July 2020 and must be considered as part of tax structured products and corporate restructurings.

Transfer Pricing

Ireland's transfer pricing rules were updated with effect from 1 January 2020, with a number of changes including adoption of the 2017 OECD guidelines on transfer pricing, as well as the extension of the rules to non-trading transactions and to capital transactions.

Financial Regulation & Aviation in Ireland: An Outline

Alternative non-bank lenders are now commonplace across a variety of sectors such that it may include some aircraft leasing companies. The business of leasing and provision of credit to corporate entities involved in the aviation sector is an area of increased attention from financial service regulators worldwide and in Ireland. The focus from a regulatory perspective is in the areas of (1) anti-money laundering; and (2) non-bank lending and reporting of certain transactions involving the provision of credit.

Anti-Money Laundering Requirements

It is noteworthy that Ireland is not taking part in the adoption of Sixth Anti Money Laundering Directive (EU) 2018 / 1673 (6AMLD) and is not bound by it or subject to its application, due to 6AMLD having been adopted under Article 83 of Treaty of the Functioning of the EU (TFEU). Under Protocol 21 of the TFEU, Ireland has opted out of all laws made under Title V and for this reason is not obliged to transpose 6AMLD into national law. However, in our view the national laws in place in Ireland are at least as comprehensive if not more so than what is provided for in 6AMLD.

Central Registers – Record and disclosure of Beneficial Owner of legal entities

Ireland is an on-shore regulated jurisdiction and is committed to combating financial crime. Through a host of domestic and EU legislation, including the 4th and 5th Anti money laundering and counter terrorism financing directives, and the EU (Anti-Money Laundering: Beneficial Ownership of Trusts) Regulations 2021, a number of new internal and central registers are required for the purpose of collating information about the ultimate beneficial or economic owners of all companies, trusts and financial vehicles. A summary of the registers is as follows:

- Central Register of Beneficial Owner of Companies and Industrial and Provident Societies (RBO). The Companies Registration Office manages the RBO. There is an on-line portal for filing www.rbo.gov.ie. Access is available to the register to competent authorities and more limited access by members of the public.
- Investment funds and certain financial vehicles (CFV) authorised by the Central Bank of Ireland. The central registry is retained by the Central Bank.

https://www.centralbank.ie/docs/default-source/regulation/amld-/beneficial-ownership-register/beneficial-ownership-register-of-certain-financial-vehicles-guidance.pdf?sfvrsn=15

Central Register of Beneficial Ownership of Trusts (CRBOT). The Revenue Commissioners in Ireland manages the CRBOT, and this role is separate to its role in tax and customs administration. Details of beneficial ownership of trusts with Irish trustees or which hold property in Ireland, or which are otherwise administered in Ireland must be filed within 6 months of the creation of the trust. Beneficial owners, for the purpose of CRBOT, includes trustees, beneficiaries, settlors, protectors, and other people exercising control over the trust.

The requirement to set up and maintain a register of beneficial ownership is a matter of good corporate governance and it is has the advantage of ensuring transparency and access to information to combat financial crime. Most corporate entities diligently monitor such risks internally. The regulations and registers enable competent authorities to access and share information which improves and enhances the overall credibility, integrity of Ireland as host for aviation business.

Credit Reporting

Due to the low level of engagement of aviation industry with consumers and indigenous Irish enterprises, we do not anticipate an increased level of financial regulation specific to this sector. However, there is a global focus on fighting financial crime which may lead to more generalised reforms and increased regulation. This may apply to companies engaged in cross border global business. This is an area of particular interest and focus for us as legal advisers and we will continue to monitor this industry.

Aircraft Transaction Register

Statistics (Aircraft Transaction Register)(ATR) Survey) Order 2020 (S.I. No.582/2020) was signed into Irish law on 2 December 2020 and the Reporting Period commenced in January 2021.

The Order places a requirement on certain companies and individuals, if contacted by the CSO, to complete a monthly survey providing specific information relating to aircraft transactions to the CSO.

The Order, made in accordance with the EU Commission Regulations, applies to body corporates who engage in leasing, purchase or sale of aeroplanes and other powered aircraft, excluding helicopters, and applies regardless of where the aircraft is registered for aviation purposes.

The reporting requirement is monthly from January 2021 until 31 December 2024. Prior to the order, trade in aircraft by Irish resident aircraft leasing companies was not recorded as Irish imports or exports, except in the small number of cases where aircraft were added to or removed from the aircraft register and the statistical data will be analysed for its impact on Ireland's volume of external trade statistics.

The CSO has confirmed that the ATR survey has enjoyed good response rates from approximately 30 aircraft leasing respondents to date. The short monthly survey captures data on aircraft transactions, as evidenced by additions/removals from the balance sheet, while respecting the commercial sensitivity of such information. The ATR is not available to the public.

Conclusion

In Ireland, the corporate, competition and anti-trust, insolvency, examination and restructuring regimes set out in the Companies Act 2014 have been recently tested, accessed and relied upon by numerous aviation entities and transactions.

Recent business activity included high profile aviation corporate mergers and acquisition transactions, portfolio sales and purchases as well as corporate restructuring and reorganisations. Such activities are likely to continue into 2022.

The global economy remains vulnerable to significant events such as the pandemic and geo-political tensions and the period of uncertainty and instability will continue at least in the short term.

We remain committed to helping our clients in this sector, just as Ireland remains a well-established, sophisticated, and proven jurisdiction for aviation including structured finance and capital markets transactions where benefits such as bankruptcy remoteness and tax efficiencies can be availed of by investors, lenders and all transaction participants.

If you would like to discuss any aspect of the information provided above, please do not hesitate to contact our team or your usual contact in the firm.

About Our Team

Our award-winning advice on aviation financing transactions ranges from cross-border legal and tax structuring and regulation to alternative funding and joint ventures.

We also advise on contentious issues such as bankruptcy and insolvency. Along with leading local and international lessors and financiers, we also work closely with credit agencies and government bodies.

What Others Say About Us

Our Aviation & Asset Finance Team

"Knowledgeable, diligent and thorough."

"They are commercially minded when it comes to negotiations."

Chambers & Partners, 2021

Our Aviation & Asset Finance Team

"Experienced in advising major commercial airlines, aircraft leasing companies, banks and private equity funders on aviation finance matters."

Legal 500, 2021

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