Insights

CYPRUS: An Aviation Finance & Leasing Jurisdiction

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Introduction

Whilst there are many jurisdictions that are considered to be the jurisdictions of choice in the area of aviation finance and leasing[1], Cyprus is a very real alternative to each of these jurisdictions and certainly ticks all the boxes when it comes to meeting the factors taken into consideration when determining in which jurisdiction to structure the financing or leasing transaction. Ireland is generally accepted as the leading jurisdiction internationally for over 40 years[2], but we suggest that Cyprus offers a viable alternative, particularly in a market with large growth rates over the next 20 years resulting in the delivery of many new aircraft.

The aviation sector in the course of the next 20 years is going to see unparalleled growth, with the headline forecasts for the period 2015-2034 being:

- 4.9% annual growth in passenger traffic;
- 4.7% annual growth in freight traffic;
- a need for the delivery of 38,050 aircraft with a value at US$5.6 trillion, with 40% to be delivered in the Asia-Pacific region, 20% in Europe and North America and remaining 20% being delivered between Middle East, Latin America, CIS and Africa;
- in period to 2034, a 145% increase in RPK;
- by 2034 over 100% increase in passenger fleet;
- by 2034 over 65% increase in the freighter fleet.

(Source: Airbus Global Market Forecast 2015; Boeing Current Market Outlook 2015-2034)

The growth in the aviation sector is a global phenomenon, with the greater number of aircraft being delivered in the Asia – Pacific region, although there are substantial deliveries occurring in the same period in North America and Europe.

All of this points to the need to put in place ownership, leasing and finance structures which are robust and efficient and meet the needs of the owners, lessors and airlines alike. Cyprus can play a role and it represents a viable option for the creation of such leasing and financing structures.

Criteria in Choosing a Jurisdiction for Aircraft Finance & Leasing

The primary factors that are taken into account in deciding on which jurisdiction to choose to implement the aviation finance and leasing transaction are well known and can be summarily stated as follows:

- stable and secure legal system;

[1] In particular Ireland, Malta, Cayman Islands and Singapore.
[2] Ireland has over EUR83bn assets under management and half of the world's leased fleet of aircraft are leased or managed out of Ireland.

- "onshore" jurisdiction;
- favourable tax treatment;
- double tax treaty network;
- membership of EU;
- geographic location;
- licensing and regulatory requirements;
- Recognition of securitization.

Cyprus does tick all of these boxes and meets the required levels in each of these areas. Consequently, it certainly can be looked on favourably when making the choice of jurisdiction.

Stable and Secure Legal System

Cyprus is a common law jurisdiction whose laws are firmly based on English law, as now supplemented and updated by EU law. The Cyprus legal and regulatory system is well developed, stable, sophisticated and user friendly. The trite principles of law that underpin most aviation finance and leasing structures are also recognized and well established in Cyprus. Cyprus, as a jurisdiction, is very familiar with international financing principles in all areas and across all sectors including shipping, asset financing and project financing. Cyprus is well established as a shipping jurisdiction, having the tenth largest merchant fleet in the world and being the largest third party ship management jurisdiction. As a consequence, ship finance and the principles thereof, which are similar, in many respects, to those in aviation finance, are well understood and applied.

Cyprus, as a recognized finance centre, has a long history with dealing with cross-border transactions of varying natures, in particular joint ventures, financing, M&A, tax based structures, etc and its professionals have commensurate experience. Financing and leasing transactions are not new to Cyprus and, as Cyprus is a facilitative jurisdiction in this regard, it will continue to be so.

The entering into and conclusion of transactions governed by laws other than Cyprus law (most usually English law or New York law) does not raise any issues under Cyprus law and such choices of law are readily given effect to and such agreements will be given effect to and enforced in Cyprus. Furthermore choice of jurisdiction will similarly be recognized and judgments of foreign courts or foreign arbitral awards will be recognized and enforced, in general terms in Cyprus.

Furthermore, Cyprus as a full member of the EU, implements and applies all EU laws, particularly in the area of aviation, thus ensuring clarity as to applicable law.

Location

Cyprus as a location, is something that has always been and rightly so, emphasized. It is truly set at the juncture between Europe, Middle East and North Africa. This allows for easy access to and serves the needs of each of these jurisdictions. Further as a corollary these jurisdictions know and are comfortable in dealing with Cyprus.

"Onshore"

Cyprus is a full member of the European Union (EU) since 2004 and of the Eurozone since 2008 and is thus an "onshore jurisdiction" and not an offshore or tax haven jurisdiction[3]. As an onshore jurisdiction, as with many others in the EU, Cyprus does offer many favourable tax incentives to doing business in and through Cyprus, in particular a base nominal tax rate (as Ireland) of 12.5%. There are other tax efficiency benefits to be achieved and these will be analysed in the following parts of this memo.

Favourable Tax System

Cyprus tax legislation is progressive, dynamic and approved by the EU as compliant with the EU acquis and offers many benefits to those entities that decide to operate in and through Cyprus. Utilising a Cyprus company does not, in order to avail of the many tax benefits, necessitate the establishment of a place of business or presence in Cyprus, since, tax residency for a corporate entity is defined as where the effective management and control is exercised. Currently, the Cyprus Tax Authority considers a company to be managed and controlled here if all or a majority of the directors are resident in Cyprus. This has as a consequence that the company is (i) liable to tax in Cyprus at the nominal rate of 12.5% and (ii) able to benefit from treaty relief under the many double tax treaties that Cyprus has put in place.

We shall now analyse tax benefits achievable under different headings.

Corporate Tax

The legal entity commonly used in financing structures in Cyprus is the limited liability company, which if tax resident in Cyprus will be liable to tax at the rate of 12.5% on worldwide income, however deductions and allowances are available:

- all expenses incurred in the production of the income are deductible; and
- capital allowances (i.e. depreciation) are permitted at the rate of 10% per annum.

Cyprus (unlike Ireland) does not distinguish between different types of companies (trading, non-trading or qualifying companies) and treats all companies under the same tax principles, viz. liable to tax at the nominal rate of 12.5%.

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[3] This is so despite varying and continuous newspaper articles to the contrary. Cyprus has never been a tax haven or offshore jurisdiction, terms and concepts used by those not fully understanding Cyprus position in international financial planning. Cyprus prior to EU accession was a low tax jurisdiction, just like for e.g. Malta but now following EU accession is an "onshore" jurisdiction.

In a usual financing and leasing structure the tax exposure in Cyprus will be determined by:

- the gross lease income received, deducting from that,
- the finance costs to fund the acquisition of the aircraft, and further deduct,
- the depreciation.

This net figure, subject to any other deductibles permitted as being expenditure properly incurred in the generation of the income, will be liable to income tax at the rate of 12.5%.

In the event that tax is withheld (whether under a double tax treaty (DTT) or under local rules) on the lease payments out to the Cyprus company, a full credit will be allowed in Cyprus for the foreign tax which could, depending on the tax rate, greatly reduce or eliminate tax payable in Cyprus. The transaction can be structured so as to keep any tax leakage to a minimum.

Withholding Tax

As a general principle, in the context of a Cyprus structure there is no withholding tax on any outward payment from Cyprus. This is the case whether there is a DTT or not. Thus any dividend or rental or lease payments from a Cyprus company to an entity outside of Cyprus are free of any withholding tax.

The Cyprus Income Tax Laws provide for a tax credit with respect to lease payments into Cyprus and full tax credit is allowed up to the amount of the local tax exposure. Given that Cyprus has a low tax charge of 12.5%, it will be usual that no further tax will be payable in Cyprus where credit is allowed for the underlying tax paid in the paying jurisdiction – in other words if the underlying tax rate is more than 12.5% on the income paid to Cyprus, say by way of lease payment, there is no further charge to tax and those amounts can be paid out of the Cyprus company without any further charge to tax.

Looking at different types of income:

(a) Lease payments

These will be subject to a notional rate of 12.5%, however as stated above the effective rate of tax can be greatly reduced taking account of acquisition costs and other expenses.

(b) Interest Payments

Where interest is earned in the ordinary course of business, it is taxed as business income at the rate of 12.5%, again taking account of any costs incurred in the generation of that income. In other words tax will be charged on the difference (ie margin) between the cost of funding and the interest received. Tax is chargeable at the rate of 12.5 % on that margin. Any interest payments made by a Cyprus company out of Cyprus are not subject to any withholding tax.

(c) Dividend Payments

Any dividends received by a Cyprus company are not liable to tax in Cyprus and these dividends as profits of the Cyprus company can be further repatriated without charge to tax in Cyprus. Any profits from the sale of shares held by a Cyprus company are also exempt from tax in Cyprus.

Stamp Duty

In accordance with the Cyprus Stamp Duty Law, stamp duty is chargeable on agreements executed with respect to (i) assets located in Cyprus or (ii) to things to be done or performed in Cyprus. In circumstances where the aircraft will not be registered in Cyprus or that the leases signed will not be performed in Cyprus, there is no charge to stamp duty. In the event that there is any sale, transfer or disposal of an aircraft owned by a Cyprus company, there will be no charge to Cyprus stamp duty.

In the context of a Cyprus company issuing financial instruments in order to raise capital, there is no charge to stamp duty on such financial instruments.

VAT

As Cyprus is a member state of the EU, VAT laws and regulations are those adopted at an EU level, which means simply, in the context of leasing transactions, that there is no VAT liability on lease payments with full VAT recoverability (input VAT recovery) on all costs attributable to leasing activities.

Double Tax Treaties

Cyprus as a financial centre has always prided itself on the developed network of double tax treaties it has concluded which lends to its status as a favoured jurisdiction for tax based transactions, which applies in, inter alia, asset finance transactions. In view of the development of the aviation sector in the next 20 years as we have summarized above, we believe Cyprus can play a major role. Cyprus has a network of over 57 treaties, with a large number of others under negotiation. In the context of aviation, it is of interest to note treaties have been signed with CIS, China, South Africa, Singapore, Bahrain, UAE, USA, Canada and many EU countries. Further even in the absence of treaty relief Cyprus operates a system that imposes no withholding tax on payments out of Cyprus and gives credit for overseas tax payments.

Securitisation

Cyprus does not have specific securitisation legislation, however all of the principles underpinning a securitisation transaction are well established and recognized under Cyprus law[4]. Cyprus limited companies have also been used for other debt issuance programmes, such

[4] The partners of this firm have acted in advising the arrangers and managers of a proposed asset backed securitisation of consumer loans for the now defunct Cyprus Popular Bank. The transaction was not finally implemented.

as bond issues, ECP and EMTN Programmes etc., many of which have been listed, for e.g in London and Luxembourg

Other Advantages

In addition to the foregoing Cyprus offers a variety of advantages which need to be regarded in determining the relevant jurisdiction, in particular:

- Highly educated workforce;
- English is established as the business language;
- Professionals have experience and expertise in the area of aviation finance and leasing.

Cyprus is a real and viable option.

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