

# COELUM

COELUM Pronunciation: 'che-l&#228;m, is Latin for air space or sky. The Romans began questioning the rights they had in the space above the land they owned and to how high above did that right extended to. Ad coelum et ad inferos, they discussed, meaning that their right of property would extend as high up to the heavens and down to hell.

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## TAX SERIES I

# Applicability of Value Added Tax for the Transfer of Title of Aircraft | Carlos Sierra

*In this and in the next two articles to be written by this author, we will attempt to review a few relevant issues that arise in respect to the applicability of certain tax liabilities of Mexican law in aircraft acquisition transactions in Mexico. In this number, in particular, we will review the applicability of Value Added Tax resultant from the transfer of title of an aircraft object and the scope of the applicability of such tax in Mexico.*

First we will attempt to discuss the general rule that needs to be applied to determine the applicability of VAT, as is described under the terms of the Value Added Tax Law (VAT Law). Article 1 thereof states that the tax contemplated by this law must be paid by the individuals or legal entities that, within Mexican territory, conduct among others the following activities: (x) the Sale of goods, or (y) the granting of the temporary use or enjoyment of goods.

In this and in the subsequent article, we will focus our analysis on these two activities only (sale and lease of assets), considering that in relation to aircraft acquisitions these are the two principal that are usually involved, either through the transfer of title of aircraft operated in Mexico by Mexican air carriers or other operators, or by the leasing of aircraft in different forms to Mexican based operators of such aircraft. In this delivery we will concentrate on the VAT implications of the sale or transfer of title of aircraft. To commence our review, we must identify the test that Article 1 contains, which, beyond the activities that are subject to the tax to which I referred in the previous paragraph, is related to the conduction of such activities within the territory of Mexico.

Considering this to be at first sight the general rule that leads to the determination of this tax, the sale of assets conducted within Mexican territory is taxable with VAT, which shall be applicable with reference to the transfer price of the asset.

The further analysis of this matter however, contains exceptions that must be taken into consideration. Article 9 of the VAT Law describes the list of circumstances and assets for which no VAT shall be payable.

In respect to this, we must note that in considering any of the circumstances and assets that are listed under Article 9, it is no longer relevant whether the transfer of title thereof is or not conducted within Mexican territory.

In other words, if as a general rule, pursuant to Article 1, the tax is applicable only to transactions conducted within Mexican territory, it becomes evident that the cases listed under Article 9, are exceptions to such transactions that are conducted within Mexican territory when such are related to the assets and circumstances referred therein.

Paragraph IX of this Article 9 initiates by stating that, among the transfers of assets that are excepted from the applicability of VAT, are such conducted between foreign residents, which means that the transactions conducted among tax residents of countries other than Mexico are not subject to VAT.

The question that results from the above is whether the assets that are located in Mexican territory when the transfer is made, if such transfer is conducted among parties that are not tax residents of Mexico is taxable or not. The response based on Article 9 is no, considering that such circumstance is an exception to such applicability.

Stated as such, the transfer of title of an aircraft located in Mexico at the time of the transfer, when such transfer is conducted, for instance, between a resident of the US and a resident of Ireland, would not be taxable with VAT in Mexico.

The analysis above appears to be simple and very straightforward in respect to this issue, and yet many tax advisers however normally advise that the transfer of title must be at any cost conducted while the aircraft is located outside of Mexican territory in order to avoid the applicability of this tax.

This position is always regarded as safe for tax purposes based on the assumption that such tax is always applicable when the asset is located in Mexico, which as we said is the general rule. We do not intend by any means to dispute that analysis, but we like to review however whether this is plainly true in all cases and whether conducting such transfer in Mexico creates in fact a VAT tax risk for the parties involved, being well known that closing a transaction with the need to move the aircraft outside of Mexico in order for the transfer to be conducted adds important costs that are associated with the movement of

the asset, such as ground time, crew costs, fuel and other related to the aircraft operation among others.

The purpose of this article is then not to advise as to whether the transfer should be or not conducted within Mexican territory, but only to describe the applicable provisions of Mexican VAT law that are applicable to this issue and to provide elements of analysis that can be used when making the determination of where it is that a transfer should be made.

In apparent support of the argument that says that the aircraft must be taken out of Mexican territory to conduct the transfer, we should consider the applicable provisions of Article 10 of the VAT Law, which states that for the purposes of this law, the transfer of title is understood to be conducted within Mexican territory, if the asset is located within such when it is sent to the buyer, or when, if the asset is not sent, the material delivery of the asset is conducted in Mexican territory.

In respect to this, in spite of the fact that the transfer of title of an aircraft does not need to necessarily entail that the aircraft be sent to the buyer, nor that it be materially delivered as a result of such transfer, in the opinion of this author, the text of Article 10 should be dissapplied to this transfer also in consideration of the described fact that the transfer of title among foreign parties is not taxable with VAT. This should be true, even if the transfer is considered to have been conducted within Mexican territory, which means for the purposes of Article 10, even if the asset was in fact sent by the seller to the buyer, or even if such was materially delivered by seller to buyer as related therein. The transfer is not taxable with VAT in this case because the test involved is the compliance with the exception described in Article 9(IX) and not because it be considered or not to have been conducted within Mexican territory.

To sustain this line of reasoning, we must analyze then that we need not only to make a determination in reference to the location of the asset, but we also need to regard the jurisdiction where the parties have their tax resident domicile. We then have *de iure* two relevant elements to consider which are:

- The location of the aircraft at the time when the transfer is made, and
- The place of tax residency of the parties involved in such transfer.

We do not dispute then that staying out of the territory of the jurisdiction where the tax can be imposed should generally be considered as the primary element of safety that needs to be reviewed to prevent the application of the tax, but we need to consider also whether the transaction is safe with regard to the domicile of tax residency of the parties involved in the transfer.

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The consideration of this second element, is what makes it also reasonable that if the two parties involved are not tax residents of Mexico, the transfer is safe even when made in respect to an asset located in Mexican territory as such is the described exception that is contained in the already referred Article 9 of the VAT Law. (See figure A)

This is proven by the way in which the law applies to the contrary when the seller at least, or both of the parties involved, fails to meet such test and is or are considered to be tax residents of Mexico, in which case the transfer would be taxable with VAT even if the aircraft is located outside of the country when such aircraft is registered in Mexico and is thus considered to be of Mexican nationality.<sup>1</sup> (See figure B)

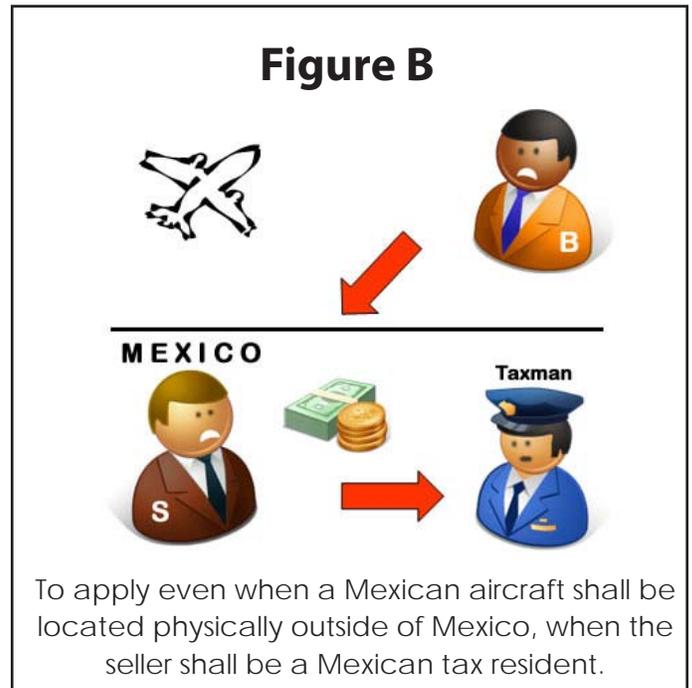
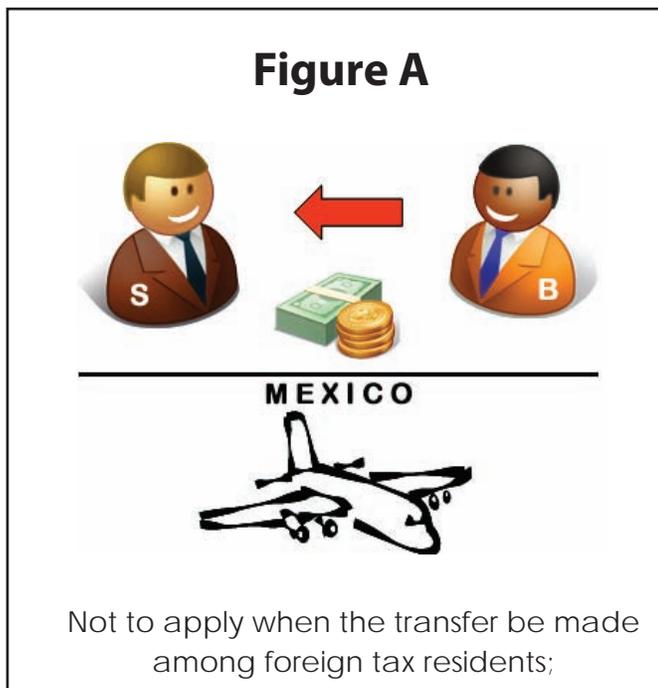
In this provision contained in Article 10 of the VAT Law, we can clearly see why we must consider the element of residency also in addition to the element of territory when reviewing the case at hand, given that the element of residency is determinant of the applicability of the element of territorial location, when the territorial consideration is dependant of the tax residency of the seller involved when the seller is a resident of Mexico. As we can see in Article 10, such residency of the seller extends the territorial reach to be applicable to the transfer of Mexican registered aircraft even beyond the physical borders of the country and beyond the determination of whether the asset was sent or was materially delivered, causing the tax to be applicable even if the aircraft shall be materially located outside of Mexican territory at the time of the transfer.

*A contrario sensu*, then, when such Mexican tax residency test is not met, it makes sense to conclude that the tax is not applicable, which explains clearly why Article 9 contains the exception to the territoriality test, when the tax residency of the two parties involved shall be outside of Mexico. (See figure C)

<sup>1</sup> Value Added Tax Law, Art. 10

When the seller is not a tax resident of Mexico, but the buyer is, the tax would not apply either, once again based on Article 9(IX), but only when the buyer shall have the benefit of a temporary importation program or regime authorized by the Mexican Government, which is the applicable regime to all aircraft dedicated by air carriers to the provision of public air transportation services.<sup>2</sup>

In conclusion, the general rule of applicability of the tax based on the location of the aircraft within Mexican territory is modified in order:



<sup>2</sup> Customs Law (Ley Aduanera) Art. 106(X)

## Mexican Aviation Registry | Misael Arellano \*

Coelum provide an analysis of the most important deficiencies of the Mexican Aviation Registry (Registry) by considering a number of issues. We will deal with the legal aspect and we will also analyze the most important operating problems that occur during the process of entry, verification, discharge and certification processes, all contained in provisions within the legal ordinances and International Agreements to which Mexico is party. We will highlight as well problems with the process of consulting and obtaining registered information.

### Introduction

The registry is of significant importance because it grants legal certainty to individuals or legal entities, involved in aviation activities. These are divided into two sections under the regulation of the Mexican Aviation Registration Regulation (hereinafter Regulation). These are: i) Aviation and ii) Civil Airports .

The Regulation guarantee rights or imposes obligations which may be asserted before any third party, when there is a legal interest deriving from acts executed between other parties. Otherwise, notwithstanding that legal agreements executed between the intervening parties are entirely enforceable between the parties, the same agreement could not apply to third parties if it had not be registered in the Registry in accordance with the requirements of the Regulation.

### Backgrounds and issues

The regulation as published on October 25, 1951 confirmed the framework regulating the Registries organization and operation.

The current Regulation was published in the Federation's Official Gazette on December 28, 2000, and entered into effect on December 29, 2000.

Although it might appear to be a recently created ordinance, with the evolution of domestic and international transactions with growing need of safeguarding rights and obligations established in private agreements which could be subject of registration, the article 47 of the Civil Aviation Law, instead of clarifying the process for the registration of these documents has become only a general base that gives to the authority the capacity to determine the admissibility of entries on a case by case-basis producing omissions and insufficiencies in the application of the Regulation.

There is no doubt that the regulation needs to be amended and work practices need updating as acknowledged by the General Director of Civil Aviation Gilberto López Meyer who has stated that Registry systems are obsolete because all processes used in the collection and consultation of information are being performed manually.<sup>2</sup>

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\* With Alejandro Lavat's collaboration

<sup>1</sup> Article 11 of the Aviation Registry Regulations.

<sup>2</sup> <http://www.eldiariodechihuahua.com.mx/notas.php?IDNOTA=96157&IDSECCION=Entorno&IDREPORTERO=EL%20UNIVERSAL>

In addition, facilities and electronic systems currently available to Registry are insufficient to serve the enormous growth which the Mexican aviation industry is going through right now. The personnel currently working at Registry admits the immediate need for growth, both in numbers as well as in training of personnel working there without appropriate facilities. They also demonstrate the need for an electronic system for the storage, analysis and consultation of information derived from the operations of their users.

### Is the Registry actually a public institution?

The public principle has been defined, by authors,, as *"the right of the general public to gratuitously and directly consult any entry in Registration folios"*.<sup>3</sup> Article 47 of the Civil Aviation Law provides that the Registry is of public nature and articles 36, 37, 38, 39, 40, 41 and 42 of the Regulation clearly states the procedures and terms to the effect that any person may have access, upon request, to information contained in the Registry files and, as applicable, may request pertinent any certifications.

Article 36 of the Regulation provides: *"Information contained in Registration books or folios is of public nature and any individual may have access thereto, after due request and after having paid pertinent duties, directly or through technological means available thereto and such information will only be provided under surveillance of individual or individuals specifically dedicated to such effects"*; in the same sense of public nature, article 37 of the Regulation provides: *"Private individuals consulting Registration books or folios may obtain any notes they deem appropriate and, if applicable, request pertinent certifications"*.

It is however evident that to the Registry access is impossible in practices, because of the procedure to which users must subject themselves in order to obtain an authorization for the consultation of the Registry files provided under the regulations.<sup>4</sup> The procedure may take up to one month or more. Once the user has obtained the pertinent permission to consult the Registry files, he must coordinate with Registry personnel and set a date and time for the Registry personnel to deliver and oversee the consultation of the requested documents.

This practice has demonstrated the absence of the Registry's public nature principle. This is the reason why users become forced to request the intervention of the Public Government Information Access Federal Institute through the Transparency and Access to Government Public Information Federal Law and its Regulation.<sup>5</sup>

It is now necessary for the administration to ensure that the Registry becomes an institution of high quality service

From all the above, and considering the entry into force of International Bonds Registration from November 1, 2007, it is now necessary for the administration to ensure that the Registry becomes an institution capable of providing high quality service and due coverage, to ensure that the Registry attain the same level of efficiency as any other Public Registry in the world.

<sup>3</sup> SANCHEZ MEDAL, Ramón. *About Civil Contracts*, México, Porrúa, 1995, 561 pp.

<sup>4</sup> Articles 36 through to 42 of the Mexican Aviation Registration Regulation.

<sup>5</sup> <http://www.ifai.org.mx/>

## News | February

### Extract of Mexican Aviation News

#### Mexico needs to leverage the aviation industry

In spite of having more airlines and larger amounts of passengers, air transportation industry is less important in the national economy and has not enough development in the Country. According to a diagnosis of the International Air Transport Association (IATA), Mexico requires quick and effective connections to the global markets of business, and more access of tourists worldwide.

Reforma, 05 / February / 2008

<http://www.reforma.com/negocios/articulo/426/851156/default.asp?Param=4&PlazaConsulta=reforma&EsCobertura=false&DirCobertura=&TipoCob=0>

#### Airlines go to the hunt of Aviacsa

Although the purchase attempt of Interjet to buy Aviacsa Airlines did not materialize, other airlines, in particular the low cost companies, could be interested in buying it, especially more for its rights of take off and landings (slots), and its facilities in the Mexico City International Airport (AICM), than for its obsolete fleet, according to analysts of the sector.

El Universal , 11/ February / 2008

<http://www.eluniversal.com.mx/finanzas/62646.html>

#### In March the Mayan Riviera Airport will be offered in open competition

In March at the latest, the Secretary of Communications and Transportation will issue the bid to build the Mayan Riviera airport, according to the Governor of Quintana Roo, Félix González. He said that companies like Airports of the Southeast (Asur) and AeroPlaza will be interested.

Milenio, 12/ February / 2008

<http://www.milenio.com/mexico/milenio/nota.asp?id=594176&sec=5>

#### Big Airlines still are the favorites

In spite of the great competition of the airlines of low cost, Aeroméxico and Mexicana continue being the leading companies in our country regarding transportation of passengers in national flights. Figures of the General Director of Civil Aviation (DGAC) show that these two companies cover almost 50 per cent of the local market.

Excélsior, 15/ February / 2008

[http://www.exonline.com.mx/diario/noticia/dinero/finanzas/grandes\\_aerolineas\\_son\\_las\\_preferidas/133223](http://www.exonline.com.mx/diario/noticia/dinero/finanzas/grandes_aerolineas_son_las_preferidas/133223)

## News | February

### Extract of Mexican Aviation News

#### Flight attendants location to strike in Mexicana and Aeromexico

The general secretary of the Union Association of Flight attendants of Aviation (ASSA), Lizett Carnation Sánchez, announced that they will be summoned to strike to Mexicana and Aeromexico, for salary demands for more than three thousand employees. They plan the convocation for the strike to be on March 31 with expiration on May 31.

El Financiero, 18/ February/ 2008

<http://www.elfinanciero.com.mx/ElFinanciero/Portal/cfpages/contentmgr.cfm?docId=105297&docTipo=1&orderby=docid&sortby=ASC>

#### Aeronautical corridor in Queretaro

From February 28, the first aeronautical corridor in Mexico will start, with the inauguration of the definitive plant of Bombardier, located at the new complex Aerospace Park of Queretaro. With this aeronautical park and the installation of two companies anchors, Bombardier and Aernnova Aerospace – the latter inside the Industrial Park Queretaro – the Government looks for getting more investments.

El Financiero, 23/February / 2008

<http://www.elfinanciero.com.mx/ElFinanciero/Portal/cfpages/contentmgr.cfm?docId=100754&docTipo=1&orderby=docid&sortby=ASC>

#### The AICM is in the top five in Latin America

According to the annual study of quality in the service of world airports carried out by the Airports Council International (ACI), Mexico City International Airport (AICM) ranked 3 in 2007 in Latin America and the Caribbean. The worldwide ranking that qualifies the airports is based on the results of almost 200 thousand surveys applied passengers during 2007.

El Universal, 27/ February / 2008

<http://www.eluniversal.com.mx/finanzas/62920.html>

#### After proposals of Canaero, DGAC begins revision

Airlines around the world will face again one complicated year due to the deceleration in the rhythm of the global economy and the uncontrollable rise of the fuel. Only in January the IATA, which represents 240 airlines with 94 percent of the air traffic of the orb, informed that the growth of passengers in January 4.3 percent vs 6.7 percent of December hardly grew.

El Universal, 28/ February / 2008

<http://www.eluniversal.com.mx/columnas/70182.html>

## Contributors



### CARLOS SIERRA

Attorney at Law: Admitted to practice law in 1991. Mr. Carlos Sierra, of Mexican nationality obtained his law degree at the Universidad Nacional Autónoma de México (UNAM). Mr. Sierra attended post-graduate studies at programs by Duke University and the Université Libre de Bruxelles in Belgium, at the International Air Transport Association (IATA) in Geneva, Switzerland and at the Escuela Libre de Derecho in Mexico City and obtained an LL.M. degree in international air and space law at Leiden University, The Netherlands. During his career he has rendered his professional services to numerous entities related with aviation law, aircraft and asset finance and leasing, telecommunications law, corporate law, antitrust law and real state law. e-mail: [csierra@asyv.com](mailto:csierra@asyv.com)



### MISAEEL ARELLANO

Attorney at Law: Admitted to practice law in 2006. Mr. Misael Arellano, of Mexican nationality obtained his law degree at Instituto Tecnológico y de Estudios Superiores de Monterrey , Mexico City and attended studies in Social Sciences Program 2003 by Universidad Antonio de Nebrija, Madrid , Spain . LANGUAGES: Spanish and English. PRACTICE AREAS: Aviation Law, Industry Affairs with Aviation Authorities, Real Estate and Corporate Law. e-mail: [marellano@asyv.com](mailto:marellano@asyv.com)

## ABOGADOS SIERRA Y VAZQUEZ

Prol. Reforma N° 1190 Piso 25  
Santa Fé México D.F. 05349  
t. (52.55) 52.92.78.14  
f. (52.55) 52.92.78.06  
[www.asyv.com](http://www.asyv.com)  
[mail@asyv.com](mailto:mail@asyv.com)

members of  [www.advoc.com](http://www.advoc.com)

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