

COELUM

COELUM Pronunciation: 'che-läm, 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.

newsletter |

monthly digital publication by

ABOGADOS SIERRA Y VAZQUEZ

www.asyv.com

january 15, 2010

year 04 | No. 09

CONTENTS

Dream of Generations...

100 years of Mexican Aviation.

Carlos Sierra

P. 01-03

Transfer of Property Rights of Leased Aircraft
Temporarily Imported into Mexico: a VAT Tax
Perspective.

Kendra Medina

P. 04-05

DECEMBER NEWS on
Mexican Aviation

P. 06-07

Contributors

P. 08

Dream of Generations...

100 years of Mexican Aviation. | Carlos Sierra.

Less than 20 years apart from the conception of a heavier-than-air aircraft by visionary Samuel Pierpont Langley which he published in his *Experiments in Aerodynamics* in 1891, where he mentioned: “I have now been engaged since the beginning of the year 1887 in experiments on an extended scale for determining the possibility of, and the conditions for, transporting in the air a body whose specific gravity is greater than that of the air...”¹ and which resulted in several fragile crafts that managed to fly for barely a few seconds; also only seven years apart from the successful first flight of the Wright brothers on December 17, 1903 and only very few years after many others were continuing to experiment with new ways to create the cherished flying machine that would fulfill the ‘dream of generations’, as the quest of the conquer of air by man had been dubbed by Mexican poet Amado Nervo,² on January 8, 1910 on the Balbuena fields, which now have been swallowed by the growth of Mexico City, Alberto Braniff, a wealthy Mexican sportsman and entrepreneur, operated a heavier-than-air Voisin aircraft for the first time in Mexico and Latin America. A record also considering that never before an aircraft had been operated from an airfield located at an altitude of 2,230m. (7,316 ft.) above the sea level.³

After the departure of president Porfirio Diaz to his exile in France in 1910, during an air show mounted upon the enthusiasm that resulted from the successful flight of Alberto Braniff by

the Moisant International Aviators group on November 30, 1911 only a few days after Francisco I. Madero had been sworn as new president of Mexico, while assisting the air exhibition and at the invitation of pilot George Dyot, the president agreed to fly on the Deperdussin aircraft operated by Dyot. Temerary as the ten minute flight was considered by critics, it marked the first time ever that an acting head of state ever flew on board an aircraft.⁴

It was still during the Mexican Revolution war when the Constitutionalist Army commanded by General Venustiano Carranza began using aircraft with military purposes barely after the First World War had commenced. It was also during the Mexican Revolution that the first air-sea battle in the world took place using a Marin “Pusher” bi-plane aircraft named “Sonora” equipped with a 50hp Curtiss engine to attack war ship “Guerrero” during the fight between the forces of general Victoriano Huerta against the Constitutionalist Army on April 14, 1914.⁵

At the end of the Mexican Revolution in 1921 the modern and developed railroad network that connected the nation was badly damaged and largely inoperative as a result of the extended armed conflict, for which, given the territorial extension of Mexico, aviation was called to play a substantial role in the reconstruction of the country and in restoring transportation services and trade. The strategic geographical location of the country and its direct access to the United States caused

1.- *Experiments in Aerodynamics*, Samuel Pierpont Langley, American Institute of Aeronautics and Astronautics, 2005.

2.- *Mexicana, 75 Años de Historia*, Manuel Ruiz Romero, Medios Publicitarios Impresos, S.A. de C.V., 1996, p. 12.

3.- *La Aviación Durante la Revolución Mexicana*, Manuel Ruiz Romero, Soporte Aeronáutico, México, 1988.

4.- *La Aviación Durante la Revolución Mexicana*, Op. Cit.

5.- *La Aviación Durante la Revolución Mexicana*, Op. Cit.

several foreign entrepreneurs and companies from countries such as the United States, Germany, Great Britain and France to become interested in the establishment of air services in Mexico.⁶

The booming development of oil production in the vicinity of Tampico in the state of Tamaulipas started to have explosive growth around 1918. The arrival of tools, ships and resources and the outgoing of oil through the port of Tampico were intense, albeit the means of transportation between Mexico City and Tampico were still difficult and lengthy. This prompted American entrepreneurs Lody A. Winship, Elmer Hammond and Harry Lawson, in joint venture with the Lincoln Aircraft Corporation to initiate air services between Tampico and Mexico City, between Mexico City and Tuxpan, another prosperous oil production city, and Brownsville in Texas from where many products and supplies were transported for the oil industry, giving birth to Mexican commercial aviation.⁷

With the development of aviation services naturally came the need and necessary impulse to manufacture aircraft. This effort started with the first aircraft ever to be assembled in a Latin American country by pilot Juan Guillermo Villasana who in 1912 built a two seater Deperdussin aircraft mounted with an 80hp Anzani engine.⁸

By 1917 the Mexican aviation industry was already substantially developed, The entity known as *Talleres Nacionales de Construcciones Aeronáuticas* (TNCA) was building several aircraft manufactured in Mexico, many of

which were also by that time using Mexican made engines and propellers. Models such as the “*parasol*”, the first aircraft built by the TNCA, the “*Serie A*” biplanes and “*Serie H*” monoplanes and engines such as the “*Aztatl*”, “*Trébol*” and “*SS México*” and the “*Anahuac*” propellers gave success and pride to a true Mexican aviation manufacturing industry.⁹

These events placed Mexico together with a handful of nations at the forefront of aviation in the entire world. Few were still the nations that, by that time, already counted with any aircraft in operation, few were also the nations that had integrated such artifacts to military, commercial and other specific uses with such success and much fewer were such that, also successfully, were manufacturing aircraft and engines by that time.

After the assassination of President Venustiano Carranza and the assumption of government by President Alvaro Obregon, who in exchange of recognition of its government by the United States executed the pacts known as the Bucareli Treaties of 1923¹⁰, certain critics believe that the development of aircraft manufacturing was brought to an abrupt end as Mexico was said to be impeded by virtue of these pacts to develop the necessary technology and to manufacture aircraft and aircraft engines for between 50 and 75 years. Much has been said and speculated about these treaties over the years which have been always believed also by critics to have been hidden from the public light. The truth is that none of these impediments legally exist however some may wish to speculate about this excuse.

6.- *Mexicana, 75 Años de Historia, Op. Cit.*

7.- *Mexicana, 75 Años de Historia, Op. Cit.*

8.- *La Aviación Durante la Revolución Mexicana, Op. Cit.*

9.- *Aviones Caza Mexicanos de Construcción Nacional, Biplano Serie C, Microplano Veloz, Oscar Fernando Ramirez Alvarado, Mexican Aviation History 2009, as appearing in <http://www.mexicanaviationhistory.com/articulos/articulo.php?id=22> on January 3, 2010.*

10.- *Biografía del Poder, Vol. 6. Alvaro Obregón, Enrique Krauze, Fondo de Cultura Económica, 1987.*

Whatever the reason to which this may be attributed, Mexico has clearly lost its way in building a successful aviation industry. Commercial aviation continues its struggle for success, in example of which Mexicana Airlines continues to be one of the oldest airlines in the world since it was founded in 1921. The lack of government support however ever since the initial momentum was so abruptly interrupted, the outdated, imprecise and inadequate legal framework under which aviation operates and the still absent aviation policy that this country has needed for decades have never allowed this industry to recover its original pace. Victim of corruption, inefficiency and the voracity of long lasting interests, a moribund industry fights to survive as it “celebrated” its 100th anniversary on January 8th.

Aviation has been in Mexican blood since it was ever created by the visionaries of its earlier days. It needs to revive again from its ashes to grow again to the heights it once deserved. When, how? That remains to be the question while the “*dream of generations*” continues to be a pending assignment to be achieved.

Transfer of Property Rights of Aircraft Temporarily Imported into Mexico: a Tax Perspective. | Kendra Medina.

In the previous edition of Coelum, we wrote about the importation rules existing in Mexico and provided a general overview of the temporary importation rule, as it is the most popular regime used by Mexican operators to import leased aircraft, aircraft objects (engines, propellers, etc.) and helicopters into Mexico, due to the significant benefit provided by Mexican law for this type of importation. Aircraft and helicopters imported into Mexico under the temporary importation regime are exempted from paying the applicable Value Added Tax (VAT) to all other imported goods (16% of the applicable general importation)¹ and are permitted to stay in Mexico for a maximum of ten years, after which they must either be returned or definitively imported into Mexico by paying the corresponding importation duties and VAT. This works well, as ten years which is pretty much the standard life cycle for any leased aircraft within a commercial fleet.

“...certain particulars of the temporary importation rules in more depth, may have a significant impact on tax contingencies and other liabilities...”

Further to our previous edition, we believe is worth analyzing certain particulars of the temporary importation rules in more depth, as they may have a significant impact on tax contingencies and other liabilities that may result from transactions as common as a transfer of property rights of leased aircraft and helicopters leased to Mexican operators. In this article we will address the dilemma resulting from certain interpretations of the Mexican customs legislation with respect the limits to which the transfer of property rights over a leased aircraft and helicopters temporarily imported into Mexico is subject to. The knowledge of this dilemma is not only of interest to the importer, but to the holder of the property rights to the equipment.

Mexican Customs Law expressly provides that the property title or use of temporarily imported goods may not be sold or transferred, except for those goods sold or transferred between limited types of companies (maquiladoras), which is usually not applicable for foreign aircraft lessors, foreign and domestic aircraft owners or domestic aircraft operators.²

The rules and regulations of Mexican Customs Law do not distinguish or clarify who must be abide by this provision. For instance, the general rule is that the VAT is not generated by the sale

1.- The general importation tax may vary from 10% to 20% of the value of the imported aircraft for customs purposes, depending on the weight of the aircraft

2.- The companies exempted from this statutory provision (Article 105 of the Mexican Customs Law) are: maquiladoras, companies holding an export program authorization granted by the Ministry of Economics and companies registered before the Ministry of Economics as exporter companies. The purposes of this exemption is to give incentives to Mexican producers to export goods by exempting them from the VAT on imported goods that are necessary in order to add some value to these goods or to transform them for purposes of exportation.

between foreign tax residents of goods located in Mexico.³ However, if a Mexican aircraft operator leases an aircraft from the aircraft owner tax resident of country Y, imports the aircraft into Mexico on a temporary basis, and the aircraft owner would like transfer its property rights over the aircraft to a purchaser tax resident of country Y and both consider Mexico as a proper jurisdiction to complete the sale for tax or any other purpose, if Article 105 of the Mexican Customs Law is strictly interpreted and the aircraft remains imported under the temporary regime, such transfer would be in breach of the aforementioned statutory prohibition.

“The rules and regulations of Mexican Customs Law do not distinguish or clarify who must abide by Article 105 of the Mexican Customs Law.”

A more flexible interpretation could read Article 105 of the Mexican Customs Law as applicable to the importer only. That is, if a Mexican operator imports an aircraft or helicopter, the rationale of applying the prohibition provided by Article 105 of the Mexican Customs Law makes absolutely sense, provided the importer must return the temporarily imported aircraft, and if such return can no longer be guaranteed due to a transfer of rights from the importer to a third party, then the Mexican tax authorities must be assured that the applicable importation tax and VAT is either paid before such transfer takes effect (which would imply the definitive importation of the aircraft) or that the aircraft meets the temporality requirement, by being returned and taken out from the temporary regime, letting the new owner decide under which regime the aircraft should be re-imported, either on a temporary or a definitive basis.

The practical solution to this dilemma, caused by the different interpretations that can be given to Article 105 of the Mexican Customs Law that have been given so far, is to meet the temporality requirement by moving leased the aircraft or helicopter out of the country and the temporary importation regime, prior to any transfer of rights, notwithstanding that such transfer only involves foreign tax residents. This is in order to avoid unwanted consequences in the event the Mexican tax authorities apply Article 105 of the Mexican Customs Law under a strict interpretation.

It is important to have these particularities in mind when preparing any strategies that may involve the transfer of property rights over leased aircraft and helicopters imported into Mexico provided that usually all costs and expenses incurred by the Mexican lessee involved in such transactions should be for the lessor and, in the best scenario, taking an aircraft out of a temporary importation regime may imply a ferry flight, aircraft ground handling, crew costs, etc. In the worst scenario, not taking an aircraft object out of a temporary importation regime may imply payment of significant economic penalties.

However, each operation including the transfer of rights over a leased aircraft or helicopter imported into Mexico should be analyzed on a case by case basis, taking all variables into account, such as the tax residency of the parties involved and the location of the equipment. Likewise, the type of aircraft or aircraft object involved may be applicable for certain exemptions under the Mexican tax laws and regulations.

3.- VAT applies however to any sale of goods within Mexican territory. VAT applicable to sale of goods is equivalent to 16% of the price of the goods.

News | December

Extract of Mexican Aviation News

Worldwide aviation sector shows signs of recovery.

IATA, for the first time since the start of the global economic recession, says that there is an increase in demand for air tickets. In fact the traffic increased 0.5% between October of 2008 and October 2009. This is good considering that sales decreased 5.4% from September to September. According to IATA, Latin-American airlines had the best results in October, as they reported a 9% growth compared to October of last year. *Excelsior*. 03/December/2009.

Passenger numbers down in 2009.

The aviation industry passenger numbers fell this year to the levels of 2005 and it will take a couple of good years to recover the numbers that carriers require. The financial crisis and the H1N1 Influenza pandemic were two definite factors that negatively impacted this past year's development plans. November results however were much better than the market expected. It showed positive increase and then December started well with the Christmas and New Year's holiday travel. *El Universal*. 04/December/2009.

Bombardier has high hopes for regional aviation.

The Bombardier Company (Canada) believes that commercial aviation will move to regional aircraft models so as to fly passengers more efficiently. They expect an increase in demand for 100 to 150 seat aircraft. Over the next 20 years there will be a need for seventeen-thousand aircraft of this type. The company plans to continue to grow their production facilities. The executive aviation segment also predicts an annual increase of 3% in USA, 4% in Europe and of more than 5% in the emerging countries like México. Because of that, there are plans to accelerate the production level of the plant in Querétaro, where all the structures and components of the Learjet are fabricated. The establishment of this plant in Queretaro was not only because of the low cost work force but also because of the strategic location of México and particularly of Querétaro. Bombardier's aspiration is to turn Queretaro into a worldwide name for aerospace technology. *Milenio*. 07/December/2009.

Volaris to start service into Mexico City Airport.

The airline Volaris, will start service into AICM before the end of 2009. The airline requested authorization to initiate a Mexico City-Tijuana route, which could start in the next few weeks. Volaris's entry into AICM is due to the existence of available slots (airlines departure and landing openings) after the exit of several local airlines. *Reforma*. 07/December/2009.

GAP's November traffic drops 2.9%.

Grupo Aeroportuario del Pacífico (NYSE: GAP) reported that total passengers decreased 14.5 percent from January to November this year. In a report sent to the Mexican Stock Exchange (BMV), the airport company explained that there was a decrease of 2.9% in November 2009, compared to a similar period last year. GAP said that domestic passengers in November dropped 1.7%, while the international passengers decreased by 5.2% compared with November 2008. *Milenio*. 08/December/2009.

Interjet: Volaris may generate a price war.

CEO of Interjet welcomed Volaris to the AICM (MEX). He said that the arrival of Volaris will generate higher competition between airlines. He also explained that Interjet may experience a drop in their profits but it is also possible that the arrival of Volaris is going to promote the competition between airlines even though some will not be able to stand a decrease in tariffs and eventually will disappear. *La Crónica*. 09/December/2009.

News | December

Extract of Mexican Aviation News

Viva Aerobús to start service from Mexico City.

Viva Aerobus will launch service from Mexico International Airport. Its arrival is planned for January. Viva Aerobus will operate flights from Monterrey and Guadalajara. They also have plans for growth which include the opening routes to Chihuahua, Ciudad Juarez, Cancun and Las Vegas to cover the twelve new routes to be added in the first quarter of 2010, VivaAerobus will add of four Boeing 737s to the fleet, which will be received between mid December and February. The manager said the airline also aims to connect passengers at ACIM with bus stations in Mexico City, through the alliance they have with IAMSAs buses, owned by businessman Roberto Alcantara, who is now president of VivaAerobus. Milenio. 09/December/2009.

Interjet seeks to buy Volaris.

A very complicated year for Mexican aviation is finally over. This was mostly due to the recession and the H1N1 virus epidemic. The Mexican government spent huge amounts of money through ASA and the SCT in order to support the aeronautical industry, a possible merger between Aeromexico and Mexicana was contemplated but not concluded. Mexican airline problems will continue in the new year with big losses, and a drop in passengers. Airlines will tackle these issues with ticket cost increases and route elimination. Based on this forecast, Interjet owners are discussing the possibility of buying Volaris to help tackle the new year by uniting their efforts. Negotiations continue but nothing is settled yet and many variables need to be agreed before any action is to be taken by these two airlines. Never the less the shareholders have issues with the competing airline shareholders and the negotiation can be a little rough, but while a merger is still possible, we will have to wait for the conclusion of negotiations. El Universal. 15/December/2009.

Fifteen airlines will run on bio-fuel.

Fifteen cargo and passenger airlines from México, US, Canada and Germany executed agreements for the purchase of millions of liters of bio-fuel made out of carbon. These agreements were executed with AltAir Fuels who intend to manufacture around 285 million liters of carbon biofuel per year. The participating airlines wish to stimulate the competition in the aeronautical industry with this new fuel alternative. La Crónica. 16/December/2009.

ASA formalizes its international consulting agency.

After several years of work and some pilot projects, Airports and Auxiliary Services (ASA) has won international contracts to provide consulting services on airport construction, analysis of aeronautical matters and tendering processes in the sector, said Jorge Nevarez, director of consulting and business development of this government agency. To date, ASA has achieved contracts with revenue of 300 thousand dollars, but ASA is seeking to increase this revenue. Reforma. 18/December/2009.

December showed a 1% increase in the number of flights worldwide.

The number of regularly scheduled flights for December by airlines around the world reached 2.4 million, 1% higher than the same month in 2008. December is one of the most important travel months. The airline statistics company "Official Airline Guide" (OAG) reported that the total capacity of these flights is 294.8 million seats, 4 percent more than in December 2008. Low-cost airlines have increased number of flights by 10 percent, with 444,539 scheduled flights representing 18 percent of the total, with 65.6 million available seats, or 22 percent of total capacity. Meanwhile, Latin America is experiencing a growth in the number of scheduled flights and seats within the region. Milenio 23/December/2009.

Contributors



CARLOS SIERRA

Attorney at law by the 'Universidad Nacional Autónoma de México' (UNAM), has coursed post-graduate studies in civil and commercial law at the 'Escuela Libre de Derecho', international law courses imparted by Duke University and the 'Universite Libre de Bruxelles', aviation contracts law at IATA and LLM studies in Air and Space Law at Leiden University in the Netherlands. After being in-house counsel for Mexicana Airlines, he has been in private practice for fourteen years advising lessors and financiers in transactional work related to the leasing and finance of aircraft and the enforcement of their rights during default, liquidation and bankruptcy proceedings. Mr. Sierra has written several articles related to aircraft finance and leasing, the Cape Town Convention and Protocol, repossession of aircraft, aviation law and Mexican commercial law and is currently a member of the Legal Advisory Panel of the Aviation Working Group. e-mail: csierra@asyv.com



KENDRA MEDINA CHAVEZ

Attorney at Law: Admitted to practice law in 2000. Ms. Kendra Medina, of Mexican nationality obtained her law degree at Instituto Tecnológico Autónomo de México (ITAM), Mexico City and completed a post-graduate Diploma in Telecommunications Law at ITAM and a Masters Degree of E-Law at the University of Melbourne, in Australia. She has attended post-graduate studies in Airline Contract Law and, Aircraft Acquisition and Financing, by the International Air Transport Association (IATA) in Montreal, Canada. Ms. Medina has contributed as member of the editorial board for the magazine of the Science and Technology Law Section of the American Bar Association. LANGUAGES: Spanish and English. PRACTICE AREAS: Aviation Law, Aircraft Contract Law and Corporate Law. e-mail: kmedina@asyv.com

ABOGADOS SIERRA Y VAZQUEZ

Prol. Reforma No. 1190 25th Floor

Santa Fe México D.F. 05349

t. (52.55) 52.92.78.14

f. (52.55) 52.92.78.06

www.asyv.com / www.asyv.aero

mail@asyv.com

members of **advoc** www.advoc.com

The articles appearing on this and on all other issues of Coelum reflect the views and knowledge only of the individuals that have written the same and do not constitute or should be construed to contain legal advice given by such writers, by this firm or by any of its members or employees. The articles and contents of this newsletter are not intended to be relied upon as legal opinions. The editors of this newsletter and the partners and members of Abogados Sierra y Vazquez SC shall not be liable for any comments made, errors incurred, insufficiencies or inaccuracies related to any of the contents of this free newsletter, which should be regarded only as an informational courtesy to all recipients of the same.