

# COELUM

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## COELUM

Pronunciation: 'che-l&m, is Latin for airspace 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.

# Transfer of Title of Aircraft by means of Lease Assignment vs Lease Novation.

by Viridiana Barquín.

In this article, we will approach the elements to be considered in respect to the transfer of title of an aircraft, between two foreign residents by way of a lease novation or an assignment agreement.

*“But what happens when the transfer of title of an aircraft that has being operated by a Mexican carrier, is conducted between two foreign residents?”*

The transfer of an aircraft or the stock of the corporation (or the beneficial interest in the trust) that owns the aircraft does not have tax consequences in Mexico unless the country of residence of any of the parties involved would be Mexico or unless the place where the payment obligations of the lessee under the lease agreement would now be required to be complied with within Mexican territory. Therefore, except these two circumstances, no sales or use tax, VAT, capital gains or any other tax would be imposed in Mexico by virtue of the transfer of title or by the diversion of the rental payments that would be resultant therefrom. In addition, the sale and purchase of an aircraft when material delivery thereof is conducted within Mexican territory is subject to 16% VAT, likewise, the transfer of title of Mexican registered aircraft among tax residents of Mexico is subject to a 16% of Value Added Tax (VAT)<sup>1</sup>, even if the aircraft is not located in Mexican territory at the time of the transfer.

But what happens when the transfer of title of an aircraft that has being operated by a Mexican carrier, is conducted between two foreign residents? What happens if this transfer of title involves a change of the lessor as well? And moreover, what would be the best mechanism to document such transfer, by means of lease novation or a lease assignment?

Mexican law does not impose any constraints upon the form or content of a lease novation or a lease assignment agreement, nor in respect to the transfer of title of the asset; in fact, the transfer of rights under such models are fully recognized and enforceable under the laws of Mexico. However, although there are no special provisions that must be included in such contracts; when considering entering into a novation or assignment agreement, it is relevant to be aware of the effect that each of such terms will have under Mexican law. Article 2213 of the Federal Civil Code states that there is novation of a contract when the parties therein substantially amend its terms by replacing a previous obligation by a new one; however, since the previous obligation is being extinguished, the term novation involves the interpretation that the prior lease is terminated and a new lease is being entered. This would have implications from a fiscal standpoint in Mexico, considering that the termination of the original lease would terminate the right of the lessee to maintain possession of the aircraft.<sup>2</sup> This would mean that the aircraft would have to be delivered again to lessee under a new lease. The delivery of the aircraft to the lessee under the new lease while the aircraft is located within the Mexican territory would cause VAT to be applicable to rental payments at a rate of 16%.<sup>3</sup>

1.- Article 1 of Value Added Tax Law (“Ley del Impuesto al Valor Agregado”).

2.- Pursuant to Article 21 of the Value Added Tax Law, VAT would be applicable without exception, to the grant of use and enjoyment of assets within Mexican territory, (i.e. to the lease of aircraft that are located in Mexico when such are delivered by lessor to lessee), in which case VAT on rental payments would apply.

3.- The general rule in accordance with Article 1 of the Value Added Tax Law is that it applies to the sale of goods and services, to the grant of use and enjoyment of assets and to the importation of goods and services that is conducted within Mexican territory. Notwithstanding, there is a relevant exception contained in Article 9 Paragraph IX, by which VAT shall not be payable on the sale of assets conducted between foreign entities. However, Article 10 on the other hand, states that the sale would be understood to be conducted within Mexican territory, if the asset is located in such territory when shipment is made to the buyer and when, in absence of shipment, the material delivery of the asset by seller to buyer is conducted within the country. Considering this, while we can easily see that the test of Article 9(IX) is clearly met simply to the extent that both, seller and buyer, are foreign entities causing VAT not to be applicable notwithstanding that the aircraft would be located in Mexico; the shipment or the material delivery of the asset must not be conducted as a result of the transfer while the aircraft is located within the territory of Mexico.

An assignment, on the other hand, involves the mere transfer of the rights and obligations of the lessor in respect to the leasing of the aircraft under the lease. The original lease in this case would not terminate and the continuing right of possession of lessee would not become interrupted for which no new delivery would need to occur and thus, there will not be any tax consequences in Mexico, even if the aircraft is located in Mexican territory at the time of the transfer. The ownership rights over the aircraft are being transferred between foreign entities which are not considered to be Mexican residents for tax purposes, then, as long as it can be evidenced that the possession of the aircraft has remained and will be remained at all times with the importing party while the Aircraft is in Mexico, there would be no grounds for any sanction either in terms of customs formalities. It is important to distinguish the parties involved in a transaction where an aircraft imported into Mexico on a temporary basis is sold, since Article 105 of the Mexican Customs Law (“Ley Aduanera”) provides the obligation for the importing party<sup>5</sup> to maintain the possession of the aircraft in order to be able to comply with the return date which is mandatory.

As it has been explained, if the possession has and will be remained at all times with the importing party while the aircraft is in Mexico, there would not be any sanction. In fact, the Tributary Administration Service (“Servicio de Administración Tributaria”) has determined that in respect to the transfer of the asset conducted between two foreign entities Article 105 of the Customs Law would not apply.<sup>6</sup>

For all that, an assignment of the rights of the lessor under the lease would not create the effect of termination of the existing lease that the novation would provoke, being such alternative more adequate to avoid the interruption of the existing right of possession of the lessee in regards to the aircraft and to avoid the interpretation that the aircraft was delivered once again under a novated lease. Nevertheless, in cases where a novation is preferred over an assignment to document the transfer of rights under a lease, it would be important to consider that in order to avoid VAT the closing of the novation would need to take place while the aircraft is located out of the territory of Mexico, and in respect to the transfer of property rights, it is important to take care that the bill of sale or the document by which the transfer of title is evidenced, does not make any reference and does not admit any interpretation that such transfer could had been conducted within Mexico.

### **In Conclusion:**

- a) conducting the transfer of the aircraft between two foreign entities as long as lessee remains in possession of the aircraft during the transfer process, does not require the placement of the aircraft outside of Mexico and does not require the export and re-importation of the aircraft;
- b) conducting the transfer of title between two foreign entities and entering into a novation agreement would require the transfer of the aircraft outside of the country to prevent VAT on rental payments that would result from the new delivery of the aircraft while in Mexico under the new lease. This process could also require the exportation and re-importation of the aircraft to be conducted by the lessee.

*4.- Evidence that is easily provided with the simple specification in the assignment agreement that in fact, the rights of possession of the lessee have not been in any way limited or interrupted at any time.*

*5.- The importation of the leased aircraft is a liability of the lessee and is therefore irrelevant if the owner of the aircraft changes during the ten years within which the Temporary Importation Regime last, considering that the lessee as importer is obliged to maintain such regime effective. It is important to note that the interpretation of the airlines has been that they are not obliged to export the aircraft and then to import it again when a transfer of title of the aircraft occurs, considering that the lease continues to be effective and they remain in possession of the aircraft during the transfer and thus, the Temporary Importation Regime continues and does not need to be affected by the sale of the aircraft. This interpretation is harder to make when a novation is entered into considering the termination of the lease and the resultant interruption of the right of possession of the lessee.*

*6.- Compilación de Criterios Normativos en Materia de Comercio Exterior y Aduanal, Boletín 2012, 35/2012/LA.*

## **Despite Slowdown, Manufacturers Remain Optimistic On Latin American Market.**

Following years of growth, which recently has outpaced the U.S. and Europe in the aftermath of the global economic downturn, 2014 has proven so far to be a bit of a corrective period for business aviation sales throughout Brazil and Latin America. Despite weakening performance in some areas, however, OEMs remain bullish about long-term demand for their business aircraft offerings. “Latin America is an important market for Textron Aviation,” Bob Gibbs, vice president of sales for Latin America for the Cessna and Beechcraft parent Company. *AINonline. August 9, 2014.*

## **ALTA Member Airlines Passenger Traffic Increases 1.8% in June.**

The Latin American and Caribbean Air Transport Association (ALTA) announced that its member airlines carried 13.6 million passengers in June, up 1.8% from the previous year. The number of passengers carried year-to-date increased 6.4% versus the same period of the previous year, reaching 85.0 million passengers. *ALTA. August 11, 2014.*

## **Phenom Leads Embraer’s Sales Charge.**

Despite some stutters in the global market, especially in the BRIC region that includes Brazil, Embraer Executive Jets continues to post good sales. By the end of June, the combined fleet had climbed to 788 aircraft operating in more than 50 countries. Sales for the first half of this year totaled 49. And, at a press conference in São Paulo on Monday, Embraer reported that market share in the business jet sector is also climbing again, reaching 17.6 percent in 2013, a figure that is almost back to the company’s 2010 high. *AINonline. August 12, 2014.*

## **PLatin America and Caribbean Ripe for Business Aviation Growth.**

The Latin America and Caribbean (LAC) region is home to more than 5,000 business aircraft—2,457 jets 2,588 turboprops—according to current data from aviation data services firm JetNet. This represents 14.8 percent of the world’s fixed-wing business turbine fleet, despite the region’s 6.6-percent share of world gross domestic product (GDP). At 851 and 824 business jets, respectively, Mexico and Brazil now have the second- and third-largest business aircraft fleets in the world after the U.S., which has a staggering fleet of 11,915 business jets.

*AINonline. August 13, 2014.*

## **Mexico flight to be at the top ten of aeronautics industries.**

As one of the destinations where the airline industry has become more flight is expected that by 2020 Mexico will become the tenth country with the largest production in the sector. Globally, the industry already has defined a significant growth, based primarily on the renovation of much of the fleets with more fuel-efficient aircraft. However, one of the main issues in Mexico will be to get on the plane of the high expected sales in the coming years is the creation of more local suppliers. At the moment there are very few Mexican companies have joined the supply chain of the industry aeronautical which they have emerged companies are already operating in other sectors, but they decided to create their division's aerospace production. *El Financiero. August 13, 2014.*

## **First transparent aircraft.**

The Centre for Process Innovation in the UK, is developing a project which may in a few years to revolutionize the field of commercial aviation. It is a technology that can create aircraft instead of windows, which provide for foreign passengers, will have a series of screens that will collect images of the sky in mid-flight, in real time. This new technology will provide passengers the feeling of being in a "transparent" plane which could revolutionize the way you travel. In addition to the visual charm, also help reduce aircraft weight and therefore lower fuel consumption. *El Informador. August 28, 2014.*

## **Mexico's Aerospace Summit.**

In looks to boost the economic potential and opportunities that Mexico provides as a leader in the aviation industry, it plans to hold a Conference and Exhibition focused on Aerospace Industry investment and development in the country. The conference to be held on October this year, in Queretaro, where many aerospace industries are set. The Industry has grown to over 300 manufacturers this year, as opposed to an initial 100 four years ago. The main objective of the conference is to demonstrate the competitive advantages aerospace manufacturers enjoy in Mexico along the "Made in Mexico" Aerospace products. *Mexicoaerospacesummit.com. August 30, 2014.*

## **Mexican government requests new aircraft.**

SEDENA, the national defense Secretary of the Mexican Federal government, is set to renew its fleet and has made a billion dollar investment in order to renew several of the fleets for the personal transport, training and natural disaster division. The project, as explained by the SEDENA, is imperative, and is set to renovate the grand majority of the fleet, as most of the aircraft in its fleet is obsolete, for it has not been renovated in 30 years. This year it is to renovate 22 aircraft subject to subsequent modernization of its fleet through the years to come. *Notareforma. August 30, 2014.*

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