

COELUM.

The end of the Tax
Incentives in Mexico
for Aviation.
An Advantage for
the Treasury?
by Viridiana Barquín



OCTOBER NEWS on
Mexican Aviation

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.

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The end of the Tax Incentives in Mexico for Aviation. An Advantage for the Treasury?

by Viridiana Barquín.

For more than twelve years, an income tax benefit has been granted to Mexican carriers through a Decree published in the Federal Official Gazette on November 29, 2006¹. Such decree provides that a tax credit equivalent to 80% of the income tax rate² to Mexican residents using aircraft with concession or permission from Federal Government to be commercially operated and whose temporary use or enjoyment is granted by foreign tax residents (“Lessor”).

Therefore, under such scheme, absolutely all the aircraft lease agreements entered from that date until now by the Mexican carriers as lessees (“Lessee”), had been covered by such benefit in such a way that the Lessee was required to withhold an amount equivalent to 1% on account of taxes from any of the payments to be made under the relevant aircraft lease agreement to a Lessor in a country with which the government of the United Mexican States has entered into a treaty to prevent double taxation and that such shall be effective.

At that time and in accordance with the preamble of such decree the commercial Aviation “was considered” as a fundamental part for the economic development of the country, which in addition to generating important sources of employment, it would

also a trigger other related activities, such as tourism and foreign trade³.

And why is it that I say: “it was considered”? Because sadly and unfortunately, this decree has been repealed as reported in the Compilation of Normative Criteria (“*Compilación de Criterios Normativos*”) published by the Tax Administration Service (“*Servicio de Administración Tributaria*”), and with this, the Benefit of the discount of 80% established thereunder is totally eliminated, so the Mexican carriers will now be obliged to withhold a 5% (instead of only the 1% of which they had been credited since 2006).

“At that time, the commercial Aviation “was considered” as a fundamental part for the economic development of the country...”

It seems then that the objectives set forth in such decree of avoiding the cost increase and boost the competitiveness of the sector at an international level, are no longer a priority for the current administration and unfortunately nor for the Mexican President.

What does this imply for the aircraft lease agreements effective as of today? The Lessee as the tax payee is the only obliged

1.- [http://www.ordenjuridico.gob.mx/Federal/PE/APF/APC/SHCP/Decretos/2006/29112006\(1\).pdf](http://www.ordenjuridico.gob.mx/Federal/PE/APF/APC/SHCP/Decretos/2006/29112006(1).pdf)

2.- 5% pursuant to article 158 of the Income Tax Law (“*Ley del Impuesto Sobre la Renta*”). Such Article determines that the tax applicable to commercial aircraft will be determined by applying a rate of 5%; provided that such assets are used directly by the lessee in the transportation of passengers or goods. Last amendment published in the Dederal Official Gazzete on November 30, 2016. http://www.diputados.gob.mx/LeyesBiblio/pdf/LISR_301116.pdf

3.- See Coellum No. 13, May 2007. <https://www.asyv.com/images/coelum/2007/may07.pdf>

subject in this case, and the only one affected with the elimination of this Benefit, so there should bear in mind that the fact that this decree ceases to take effect, in any case harms to the tax payee only; i.e., the Lessee.

What about gross-up provisions?

It is important to note that the provisions of any aircraft lease agreement relating to an obligation on the part of the lessee to gross-up any rent payments for withholding taxes or other withholding amounts, will continue being fully enforceable.

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Should there be a concern in case of transfer of title or assignment or fan aircraft?

Absolutly not. As it has been explained in other editions, this will not interrupt the temporary posesion of the aircraft by lessee nor in any way be considered as a termination

of an existing lease to another start from cero. The existing lease will continue for the originally agreed term and the change of lessor and/or owner does not imply that the Lessee lose the right of withhold the 1% only.

In conclusion, yes; this definitely represents a headache and a cost increase for the Airlines in Mexico (and for the sector without a doubt) and it is obvious that under the guise of avoiding evasion, this entails a collection advantage for the tax authority. However, the existing aircraft lease agreements should not cause any concern; as for those entered from now on, the caution that should be met for the obligation to gross up and to pay the full amount of rent net of any applicable taxes, continues being legally enforced in Mexico against Lessee, is that such obligation is expressly assumed by Lessee under the aircraft lease agreement.

4.- Article 105: “the ownership or use of goods imported under the temporary regime may not be subject to transfer or sale, except for those with authorized export programs authorized by the Ministry of Economy and foreign trade companies that have registry from the Ministry of Economy, when they meet the conditions setforth in the relevant Rules”.

Last amendment published in the Dederal Official Gazzete on June 25, 2018.

http://www.diputados.gob.mx/LeyesBiblio/pdf/12_241218.pdf

The Delft University of Technology, presents the scale design of the “Flying-V” Aircraft.

The design of the Flying-V Concept Aircraft, an equipment that consists on a passenger cabin, cargo hold and fuel tanks on the wings, capable of consuming 20% less fuel, was presented on a scale design by the Delft University of Technology. The project led by Professor Peter Vink and designer Thomas Rotte, aims to improve the passenger experience with a lower weight and a capacity comparable to the Airbus A350. www.a21.com.mx/index.php/innovacion/2019/10/08/presenta-tu-delft-modelo-escala-del-flying-v October 08, 2019.

The Secretary of Communication and Transportation is being asked to intervene in aviation medicine.

Aviation personnel requested the support of the Secretary of Communications and Transportation, Javier Jiménez Espriú and the Congress to reopen the authorized third-party program in order to resolve the deficiencies in the application of the medical exams they require to obtain their flight licenses, this after the present administration closed said program. www.a21.com.mx/normatividad/2019/10/06/piden-sct-intervenir-en-medicina-de-aviacion October 08, 2019.

Commercial war affects air cargo: IATA.

Cargo air transport continues to face several difficulties with the intensification of the US-China trade war, as well as weaknesses in other key economic indicators and growing political uncertainty worldwide, said the International Air Transport Association (IATA). According to data from the association, global cargo transport volumes have fallen 1% compared to last year. Only two regions worldwide presented increases in their air cargo markets: Africa, with an increase of 8% and Latin America, with a growth of 0.1% in its demand. <http://a21.com.mx/organismos/2019/10/09/guerra-comercial-afecto-carga-aerea-iata> October 09, 2019.

Will IATA’s “Crowd Sourcing tool” be able to help Airlines Avoid Turbulence?

For about three years, The International Air Transport Association (IATA), has worked on a platform known as “Turbulence Aware” that uses an algorithms developed by the National Center for Atmospheric Research, capable of collecting turbulence parameters from aircraft systems and sensors, accumulating that data and making it available in a format to participating airlines. Consequently, in the following months, the transition from the initial pilot phase of a cloud database gathering real time turbulence reports, to full operational deployment available to airlines, will take place in January. www.aviationtoday.com/2019/10/18/can-iatas-crowd-sourcing-tool-help-airlines-avoid-turbulence/ October 18, 2019.

The problem with food waste on airplanes.

It has been estimated that the average passenger of an airline leaves more than a kilo of trash on the plane, from disposable plastic earphones and cutlery to food leftovers and toilet waste. IATA (International Air Transport Association) said that, in order to increase the percentage of recycling, the rules governing the waste of food and beverages at the international level should be re-planned, which imply a complex set of international and country-specific standards aimed at preventing dissemination. of diseases. www.aviacionaldia.com/2019/10/los-desperdicios-de-alimentos-en-los-aviones-son-un-problema.html October 21, 2019.

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What benefits will the Federal Civil Aviation Agency bring in Mexico?

This week it was announced that the cycle ended for what we knew as the General Directorate of Civil Aviation (DGAC). The installation of the Federal Civil Aviation Agency was approved, and the mandate is already published in the official newspaper of the federation so, as of last October 16, it is already in operation. Since 2010, when the Federal Aviation Administration (FAA) of the United States imposed a sanction on Mexico degrading its security status by failing the international ordinary audit, it was stated that it was necessary to eliminate the General Directorate model to make way to an entity that had management and budgetary autonomy. 9 years after that recommendation, which was rather a requirement, today the Federal Aviation Agency is already a reality. However, the small details such as the Agency's Operations Manual and the new regulations that will accompany this operations manual are missing since, legally speaking, the regulations that applied until October 15, responded to the Directorate of Civil Aeronautics, so new regulations must be issued or copies of old ones, with modifications. www.transponder1200.com/que-beneficios-traera-la-agencia-federal-de-aviacion-civil-en-mexico/ October 22, 2019.

Estimate opportunity for Mexico in the aviation industry by 2036.

Mexico can become one of the largest suppliers in the airline industry by 2036, said businessman Raúl Rocha Cantú. He said that it is estimated that worldwide there will be a demand for more than 23,000 new aircraft, so the fleet will double worldwide, placing 46,000 aircraft for that year, a fact that the Mexican industry could take advantage of for development and growth, this of agreement with data issued by Daniel Parfait, director in Mexico of Safran aerospace components. In addition to this, the PwC consultancy revealed that, in a ranking of the most attractive countries for aerospace manufacturing, Mexico has the possibility of being more competitive, although it is in place 38 of 209 countries evaluated. www.eleconomista.com.mx/empresas/Estiman-oportunidad-para-Mexico-en-industria-de-la-aviacion-para-el-2036-20191024-0052.html October 24, 2019.

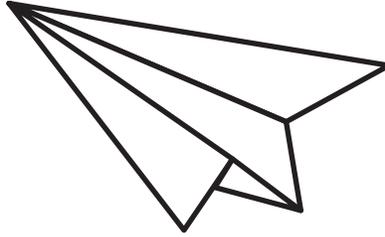
Latin airlines among the least earning in 2019.

In 2019, airlines will earn 50 cents (around 9.5 pesos) for each passenger. Latin American airlines have achieved earnings per passenger only in four of the last seven years, while in the other three they have resulted in losses. The estimate for airlines in Latin America is drastically lower than other regions such as North America, where it is estimated that in 2019 the companies will have earnings of \$ 14.8 per passenger. In addition, in Europe a profit of 6.7 dollars per passenger is expected, while in the Asia Pacific region it will be 3.5 dollars. www.aviaciondia.com/2019/10/las-aerolineas-latinas-estan-entre-las-que-menos-ganaran-en-2019.html October 28, 2019.

The industry is not involved in Saint Lucia: IATA.

From the point of view of the industry, the Saint Lucia plan is currently at zero. "I believe that building a terminal without the collaboration of airlines and the airport side would be a mistake," said Peter Cerdá, vice president for the Americas of the International Air Transport Association (IATA). IATA invited the federal government of Mexico to share all the documents and planning for the launch of the Metropolitan Airport System, consisting of the terminals of Mexico City, Toluca and, in the future, Saint Lucia. This in response to the statements of Andrés Manuel López Obrador, president of Mexico, who said during his October 29 conference, "that the airlines will be convinced to operate in Santa Lucia. www.a21.com.mx/aeropuertos/2019/10/29/la-industria-no-esta-involucrada-en-santa-lucia-iata October 29, 2019.

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