

# COELUM.

New Tax Realities for 2021.  
by Jessi Saba.



## FEBRUARY 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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## New Tax Realities for 2021.

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Recent amendments to the relevant tax laws in Mexico, as well as the recent 2021 tax bill issued as described in more detailed below, pose certain important questions to three specific relevant aspects of transactions involving the leasing of aircraft and engines. This article will briefly analyze these three important topics, the amendments to be considered and the implications thereof in regular aircraft and engine related transactions.

### Taxes Applicable to Rental Payments

#### Aircraft

For several years and through 2019, article 158 of the Income Tax Law ("*Ley del Impuesto sobre la Renta*") related to the withholding of income tax on payments to foreign lessors, stated that the leasing of aircraft by a Mexican tax resident from a foreign tax resident would be subject to a withholding applicable to 4.9% of the amount of rental payments. When the aircraft was involved in the provision of public air transportation services and when such services involved international travel, pursuant to a decree published on November 29, 2006, the 4.9% withholding rate applicable was be discounted by 80% which resulted in Lessee being required to withhold only an amount equivalent to approximately 1% (one per cent) on account of taxes from any of the payments made to the Lessor for rent under the Lease.

Recent amendments to the Income Tax Law, specifically to article 167 thereof in effect since January of 2020, now treat the withholding obligation described above as a royalty. In this regard, the temporary use and enjoyment of aircraft that are dedicated to providing public air transportation services (under a concession or permit), as long as such assets are directly used by the lessee for the international transport of passengers or cargo, will be taxed with a 1% royalty. Article 158 then is no longer applicable in this specific aspect and we now have to refer to article 167 and refer to the royalty referred thereto, rather than the withholding originally specified in article 158 and its subsequent discount.

In order for the above to be applicable, we must also analyze and determine if the specific transaction is subject to article 171 of the Income Tax Law which states that if the income is to be perceived by a person or entity, company, transparent entity or any other legal figure created in accordance with foreign law, whose income is subject to a preferential tax regime in another jurisdiction, the applicable tax rate would be of 40%. In this regard however, the recent tax bill<sup>1</sup> states in section 3.18.23 that article 171 will only be applicable when transactions are conducted between related parties as stated in article 179 section V of the Income Tax law<sup>2</sup>. Considering this, and following this analysis it could be argued that the 40% withholding will be applicable only if the operation falls within article 171 when it is conducted between related parties, as well as if there is a treaty to prevent the double taxation in place between Mexico and the counterparty jurisdiction. In such event article 167 will apply and the royalty of 1% will be applicable. If the operation does not fall within the scope of article 171 (i.e. when conducted between related parties), then regardless of whether a treaty to prevent the double imposition is in place, the 1% royalty will be applicable.

All of these recent amendments are very specific and require a thorough study in each case in order to determine exactly the applicable regime to each transaction.

#### Engines

The Income Tax Law was never specific about the tax treatment of aircraft engines, specially to stand alone engines to which use, and enjoyment was granted to a Mexican operator by a foreign entity as lessor.

The very recent tax bill in its section 3.18.38 now specifies that in respect to the royalties stated in article 167, when dealing with leased engines to be used on airplanes that have a concession or permit to be used for public air transportation, a rate of 5% over the income received by the foreign resident

1.- *Miscelanea Fiscal* issued on December 29, 2020.

2.- Section V of Article 179 refer to characteristics of operations that include the business strategies, including those related to the penetration, permanence, and expansion of the market.

will be taxed, without any deductions, as long as the engines are used by the lessee in the transportation of passengers or cargo. The underlying lease agreement must clearly state that the 5% will be withheld and paid by the Mexican tax resident.

The above mentioned provision is so poorly drafted, that the term used was “airplanes”, making no distinction between “aircraft” and “airframe”, which would aid in the interpretation of engines that are part of an aircraft, from individually engines to be installed on an airframe. It appears that the intention was to regulate and impose taxes on individually leased engines, but the statute is vague. When importing an aircraft into Mexico, the import permit mentions the airframe and the two engines and defines it as “*avión*” which would translate into airplane. The engines installed thereon are not subject to any additional withholding but rather the 1% royalty explained above.

Why would stand alone engines be subject to a 5% withholding? Could this also be applicable to other parts that are imported to be installed on an aircraft? Why is the tax treatment different when dealing with an entire aircraft, and with parts of aircraft to be assembled or installed into an aircraft used for air transportation services? These are questions that arise from the vague and poorly drafted statute of the recent tax bill, which require further clarification from the authority.

***“The above mentioned provision is so poorly drafted, that the term used was “airplanes”, making no distinction between “aircraft” and “airframe...”***

In addition to these questions, it is pivotal to consider that this precision was added on a tax bill, and not on the law per se. The legal nature of this sort of tax bills is to clarify, explain, and organize certain fiscal treatments and regulations, but we must certainly ask what happens when these tax bills impose greater obligations on the taxpayers than the law does. Is this valid? Legitimate? In first instance, it is not. The

tax bill cannot impose any obligations that are not contained in the relevant law; therefore, this criterion could be fought against, but the tax authority in Mexico (SAT) certainly expects these tax bills to be enforced. It is not clear what the path to follow will be, but it certainly involves further clarification from the authority.

### **Transparent Foreign Entities**

Article 4A of the Income Tax Law was added to the law in December 2019, and entered in full force only on January 1, 2021, reaffirming the interpretation of transparent entities in respect to payments conducted thereto outside of Mexico. The main purpose of this new article is to regulate the taxation over the income of transparent foreign entities and foreign legal figures, such as trusts, associations and investments funds. In this regard, the law defines a foreign entity and/or legal figure as transparent “*when these are not tax residents for purposes of income tax, in the country or jurisdiction where they are constituted or where their principal place of business or effective headquarters are located, and its income is attributed to its members, partners, shareholders, or beneficiaries*”<sup>3</sup>.

It is pivotal to analyze the implications and scope of this regulation and its impact in common leasing and financing transactions, and to verify who the beneficial owner is in order to determine the applicability of taxes. It is very common in the aviation industry that trusts are constituted in order to lease aircraft to operators. By way of example, a trust might be constituted in the United States or Ireland, but the ultimate and real beneficiary (beneficial owner) might not be a tax resident of a country with which Mexico has a treaty to prevent double taxation in place. If such is the case, the 1% royalty described above will not be applicable, and the withholding will increase to 40%.

***“...and to verify who the beneficial owner is in order to determine the applicability of taxes.”***

It is also important to consider the applicability of the treaties to prevent double taxation in these

3.- Article 4A of the Income Tax Law.

scenarios. Let's imagine there is a US trust, with an Irish beneficiary. If the trust is considered transparent, the treaty to prevent double taxation between Mexico and Ireland would be applicable, and if it is not considered transparent, the treaty to prevent double taxation between Mexico and the US will be applicable. The treaties apply to parties who are resident of states who have contracted the treaties, no matter the circumstances, but if an interpretation is made in the sense of application of the treaties instead of the law, there is certainly a tax risk that the tax authorities would deem otherwise and penalize the attempt to avoid taxes. It is a very delicate line, and the interpretations made in respect to these aspects could potentially affect the regular structures commonly used when leasing an aircraft in Mexico, and could imply a broader tax exposure.

### **Transfer of Title of Aircraft imported into Mexico under a Temporary Importation Regime**

According to article 1 paragraph (I) of the Value Added Tax Law (VAT Law), VAT is payable only in respect to transfers of title that have occurred within Mexican territory. In addition, in order to determine if the delivery of the aircraft has occurred in Mexican territory, we must consider two different factors: (i) tax residency of the parties involved, and (ii) the actual location for delivery. If the delivery of the aircraft or engine is conducted between two foreign entities VAT would not be payable, provided however, that the aircraft was imported into Mexican territory under a temporary importation regime or an importation program in accordance with applicable law<sup>4</sup>.

This is true regardless of the location of the aircraft at the time of transfer, as explained in article 10 of the VAT law to the extent that no physical delivery is conducted within Mexican territory at the time of transfer, but if it is conducted between two foreign entities even if the aircraft is in Mexican territory no VAT would be applicable.

The law was not specific as which types of importation regimes would be applicable for the exemption of

article 9(IX), as the law kept the interpretation open stating that this would be applicable if the asset is imported "[...] *in accordance with any other similar regime under the Customs Law*".

The tax bill described in footnote 1 above, includes in its section 4.2.6 a clarification from the tax authorities stating that for purposes of Article 9(IX), a similar regime in accordance with the Customs Law, means the operations conducted by companies that have a foreign trade program duly authorized by the Ministry of Economy.

The again unfortunate drafting of the tax bill does not limit the provisions of Article 9(IX) to exclusively a program authorized by the Ministry of Economy, and even more so, the tax bill refers to a program, not a regime under the Customs Law. It is not clear yet how to proceed on this basis, as if we consider that this limits the possibility of the parties to transfer an asset while in Mexico without applicable VAT, the aircraft will have to be exported for the transfer of title to occur and imported again into Mexican territory. A simple flight to international waters for purposes of conducting the transfer would be deemed as a simulation, as the aircraft is imported into Mexico, operated by a Mexican entity, and has Mexican registration marks. A deeper analysis is required in this regard and each transaction must be analyzed individually, but this amendment certainly causes confusion and uncertainty.

These amendments certainly pose more questions than answers and require a very thorough analysis and probably even a request to the SAT to confirm certain criteria, as the unfortunate drafting and poor analysis by the authorities of these amendments, cause uncertainty and opens the door for interpretation, which could be either favorable or not for lessors.

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4.- Article 9 paragraph (IX) of the VAT Law.

## Seeking gender equality in the airline industry.

"We need to transform the system because 'good intentions' won't change it. We need to push for women to be more involved and welcome in the industry," said Bobbi Wells, president of the International Association of Women in Aviation (IAWA) during the Steam the World webinar. According to the organization, as of December 2019 in the U.S., women accounted for 6% of all pilots, and only 2.5% in mechanic work. Numbers have steadily increased over the past two decades; however, the percentage is still low. She also said that to promote greater participation of women and achieve conditions of equality, it is required to redouble efforts through education efforts in girls and young women. Female-to-female support and mentoring of girls at an early age can help inspire today's young women to pursue a career in the aviation industry. [www.a21.com.mx/organismos/2021/02/18/buscan-igualdad-de-genero-en-la-industria-aerea](http://www.a21.com.mx/organismos/2021/02/18/buscan-igualdad-de-genero-en-la-industria-aerea) February 18, 2021.

## Ultra-clean bio turbosine launched.

The green and sustainable energy company Clean Planet Energy (CPE) created "ultra clean fuel" for airplanes from plastic waste that can be used directly to replace the use of fossil fuels, reducing CO2 emissions by 75%. The company claims that for each ton of non-recyclable plastic treated, it is possible to obtain around 556 liters of fuel. Compared to traditional fossil fuels, this clean fuel reduces CO2 emissions into the atmosphere by up to 416 kilograms per barrel. CPE currently has two plastic processing plants in the United Kingdom and plans to open another four in Europe. Its goal is to eliminate more than one million tons of plastic waste from the environment each year. [www.a21.com.mx/innovacion/2021/02/19/lanzan-bioturbosina-ultra-limpia](http://www.a21.com.mx/innovacion/2021/02/19/lanzan-bioturbosina-ultra-limpia) February 19, 2021.

## Mexico's Ministry of Communications and Transportation modifies slot rule for Mexico City's International Airport.

The slot utilization criteria for the 2021 summer season will be 50:50, replacing 85:15, which means that 50% of slots must be used, according to the Ministry of Communications and Transportation (SCT). In the winter 2019, summer 2020 and winter 2020 seasons, the use of slot rules was suspended entirely, supporting airlines facing the historic drop in demand as a result of the COVID-19 pandemic crisis; otherwise, airlines might have been forced to conduct ghost flights, i.e., without passengers, to maintain their operating schedules. [www.a21.com.mx/aeropuertos/2021/02/19/modifica-sct-regla-de-slots-para-el-aicm](http://www.a21.com.mx/aeropuertos/2021/02/19/modifica-sct-regla-de-slots-para-el-aicm) February 19, 2021.

## Request for airport processes to be made more flexible for COVID-19 vaccines.

The International Civil Aviation Organization (ICAO), and the World Customs Organization (WCO), issued a joint statement urging governments to rapidly establish airport infrastructure and facilitate customs processes to support the storage of COVID-19 vaccines as well as logistics for other medical supplies. These two, are also encouraging countries to designate aviation personnel as "key workers," who provide an essential service, all in line with the World Health Organization's roadmap for prioritizing COVID-19 vaccine uses. [www.a21.com.mx/aeropuertos/2021/02/22/piden-flexibilizar-procesos-aeroportuarios-para-vacunas-covid](http://www.a21.com.mx/aeropuertos/2021/02/22/piden-flexibilizar-procesos-aeroportuarios-para-vacunas-covid) February 22, 2021.

## Covid: Airline industry travel pass ready 'within weeks'.

The International Air Transport Association (IATA) says it expects its digital Covid Travel Pass will be ready "within weeks". The pass is an app that verifies a passenger has had the Covid-19 tests or vaccines required to enter a country. Furthermore, it also verifies they were administered by an approved authority. In fact, the industry body sees the pass as essential for reopening air travel, as many countries still have strict restrictions or quarantines in place. [www.bbc.com/news/business-56165563](http://www.bbc.com/news/business-56165563) February 23, 2021.

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## **Federal Government expropriates land in the State of Mexico to be used for the Santa Lucia Airport.**

The Government of Mexico published this Tuesday the decree that officially concludes the expropriation of land in the State of Mexico, which will be used for the Santa Lucia Airport. The decree, published in the Federal Official Gazette, mentions that the total expropriated land amounts to more than 110 thousand square meters. Those affected by the expropriation were notified of the technical and informative works between July and September of last year; and they were informed of the appraisal report for the land. "The property subject to expropriation may only be definitively occupied by means of payment made to the affected." states the decree. [www.elfinanciero.com.mx/nacional/gobierno-expropia-terrenos-en-el-edomex-seran-utilizados-para-el-aeropuerto-de-santa-lucia](http://www.elfinanciero.com.mx/nacional/gobierno-expropia-terrenos-en-el-edomex-seran-utilizados-para-el-aeropuerto-de-santa-lucia) February 23, 2021.

## **Mexico owes 3,149 million pesos for presidential aircraft.**

From 2020 to 2027, the Mexican government will have to pay an estimated amount of 3,149 million 662 thousand pesos (150,926,836 USD) for the presidential airplane, despite the early termination of the lease agreement with the Banco Nacional de Obras y Servicio Públicos (Banobras). In 2012, Banobras and the Ministry of Finance and Public Credit and the Ministry of National Defense (SEDENA), as lessor, lessee, and user, respectively, entered into a financial lease agreement for a term of 15 years, for the acquisition of the Presidential Aircraft. At the beginning of his six-year term, Andrés Manuel Lopez Obrador decided not to use it and its sale process was initiated, ordering its transfer to the airport of Victorville, California, to be safeguarded. For this operation, the SEDENA entered into a direct award agreement with The Boeing Company, manufacturer of the 787-8, with a budget ceiling of 29 million 500 thousand pesos (1,413,593 USD) for maintenance and preservation. [www.https://a21.com.mx/aeronautica/2021/02/23/debe-mexico-3-mil-149-mdp-por-avion-presidencial](https://a21.com.mx/aeronautica/2021/02/23/debe-mexico-3-mil-149-mdp-por-avion-presidencial) February 23, 2021.

## **Scrapping Mexico City's New Airport Is Costing Over \$16 Billion.**

Canceling the construction of the New International Airport of Mexico in Texcoco (NAIM), which was supposed to be Mexico City's new international airport, will cost US\$16.12 billion, according to an investigation published by the Federal Superior Audit Office (ASF). This amount was 232% more than what was previously predicted, according to the audit. However, it went crashing into controversy with Mexico's president, Andres Manuel Lopez Obrador, who claimed to have different data. One day later, the ASF admitted some methodological deficiencies in the investigation; therefore, the overall cost may be lower. [www.simpleflying.com/scrapping-mexico-citys-new-airport-cost/](http://www.simpleflying.com/scrapping-mexico-citys-new-airport-cost/) February 23, 2021.

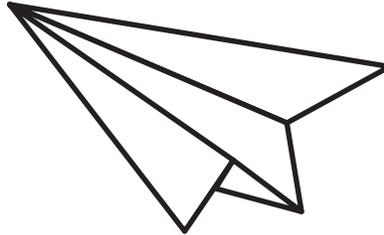
## **Air transport industry will be in red numbers throughout 2021, industry forecasts.**

The International Air Transport Association (IATA) stated that losses will be at least around \$75 billion in 2021, provided that travel restrictions are lifted when the vulnerable population is vaccinated in developed countries. However, losses could reach \$95 billion if the measures are not relaxed, especially during the summer, the peak aviation season in the northern hemisphere, particularly in Europe and North America. "If governments cannot open the borders, we will need them to open their wallets with financial assistance to keep airlines alive," said IATA Director General Alexandre de Juniac. [www.forbes.com.mx/negocios-industria-transporte-aereo-numeros-rojos-2021/](http://www.forbes.com.mx/negocios-industria-transporte-aereo-numeros-rojos-2021/) February 24, 2021.

## **Aviation in Mexico started 2021 with a 49% drop: the largest drop in its history.**

Mexico has started 2021 with a complicated panorama in the face of the COVID-19 pandemic, since in January it only registered a mobilization of 4 million 603 thousand air passengers, showing an annual drop of 49.2%, the deepest in history. According to data from the Federal Civil Aviation Agency (AFAC), in the first month of 2020, the period prior to the health crisis, a total of 9 million 065 thousand users were registered in the country. [www.milenio.com/negocios/aviacion-mexico-inicio-2021-caida-49-pasajeros](http://www.milenio.com/negocios/aviacion-mexico-inicio-2021-caida-49-pasajeros) February 25, 2021.

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