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**Aircraft Leasing.**  
*by Vera García.*

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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.

## Aircraft Leasing.

by Vera García.

Financial Lease is a triangular relationship involving a lessor who enters into an agreement with a third party in which the lessor acquires equipment (for purpose of this article, an aircraft) and enters into a lease agreement, granting the right to the lessee to use the equipment in return for the payment of rental<sup>1</sup>. According with the Unidroit Convention on International Financial Leasing, financial lease is a transaction in which the rentals payable under the lease agreement is calculated to consider the amortization of the whole or a substantial part of the cost of the equipment<sup>2</sup>. This article will describe financial lease in Mexico (especially of aircraft) and briefly explain its tax treatment.

***"The main difference between an operating lease and a financial lease is that in the latter, the lessee should adopt one of the options listed in the LGTOC at the termination of the lease..."***

Financial lease is regulated in the General Law of Operations and Credit Titles (its acronym in Spanish is "LGTOC") which defines Financial Lease as the agreement by which a person is obliged to acquire certain goods or assets and grant temporary use or enjoyment of such assets, on a forced term, to another person who is obliged to pay in installment, a determined or determinable amount of money that covers the acquisition value of such goods, financial charges and other accessories and to adopt one of the following options at the termination of the agreement<sup>3</sup>:

- I.- purchase the asset at a price lower than its acquisition value<sup>4</sup>.*
- II.- hold the asset on lease for a further period.*
- III.- participate with the lessor in the sale of the asset to a third party<sup>5</sup>.*

The main difference between an operating lease and a financial lease is that in the latter, the lessee should adopt one of the options listed in the LGTOC at the termination of the lease and the main difference between a financial lease and an installment sale or credit agreement, is that the financial lease seeks to transfer the possession of the asset for its use and enjoyment, and optionally transfer the property at the termination of the agreement, whereas an installment sale /credit agreement, seeks to transfer the property from its execution.

Article 15 of the Federal Tax Code also defines Financial Lease and includes the following requirements: i) to be granted in writing; ii) to state the exact value of the asset (or the mechanics to determine it) and iii) to state the agreed interest rate. Also, it establishes that it should be registered in the Single Section of the Single

1.-Article 1 of the UNIDROIT CONVENTION ON INTERNATIONAL FINANCIAL LEASING (OTTAWA, 28 MAY 1988). Last Updated: 01 October 2013: <https://www.unidroit.org/leasing-ol/leasing-english>

2.- Article 1 of the UNIDROIT CONVENTION ON INTERNATIONAL FINANCIAL LEASING (OTTAWA, 28 MAY 1988). Last Updated: 01 October 2013: <https://www.unidroit.org/leasing-ol/leasing-english>

3.- Article 408 of the General Law of Operations and Credit Titles (Mexico City, August 27, 1932). Last Updated June 22, 2018

4.- In case that Lessee acquires the option to buy the equipment, it should comply with the conditions subsequent established in the financial lease, such as settling all the amounts due; pay the total amount of the asset plus interest and conduct the corresponding notification to lessor.

5.- Article 410 of the General Law of Operations and Credit Titles (Mexico City, August 27, 1932). Last Updated June 22, 2018

Registry of Secured Transactions of the Public Registry of Commerce, in the electronic folio of the lessor and the lessee, to be effective against third parties<sup>6</sup>.

***"...the main difference between a financial lease and an installment sale or credit agreement, is that the financial lease seeks to transfer the possession of the asset for its use and enjoyment, and optionally transfer the property at the termination of the agreement, whereas an installment sale /credit agreement, seeks to transfer the property from its execution."***

Although for legal purposes, the lessor is always the owner of the asset, for tax purposes the lessee is the owner of the asset, since article 14 of the Federal Tax Code, establishes that a financial lease is a "transfer of assets"<sup>7</sup> and establishes that the acquirer is the owner of such assets.

*"Article 14 of the Federal Tax Code. The transfer of asset is understood to be: [...] IV. done through financial lease. [...] when there has been transfer of asset, the acquirer is the owner of such assets for tax purposes."*<sup>8</sup>

Accordingly, the Value Added Tax Law and the Income Tax Law (or its acronym in Spanish, "LISR") considers the financial lease a transfer of assets: Lessee, upon signing the financial lease, should pay the VAT applicable to the Original Amount of Investment and to the interest to be paid monthly. The lessee is entitled to deduct the VAT paid on the interests. However, the tax benefits are found in the LISR.

Article 25 of "Article 25 LISR. Taxpayers are entitled to the following deductions (...) II. The cost of what is sold (...) IV. Investments (...)." <sup>9</sup>

According with the previous paragraph, lessor is entitled to deduct the cost of the asset when the payment is received and on the other hand, lessee is entitled to deduct the investment of the original amount of the asset according to the maximum percentage authorized by law, pursuant to article 34 fraction V subsection b of the LISR, in case of aircraft, 10% percent; and at the maximum original amount of investment<sup>10</sup> permitted by law, pursuant to article 36 fraction III of the LISR, in case of aircraft, an amount equivalent to \$ 8,600,000.00 Mexican Pesos ( approximately \$430,861 USD). If, at the termination of the financial lease, lessee acquires the option to buy the equipment, it will have an additional right of deduction<sup>11</sup>. Additionally, Lessee is entitled to deduct the accrued interest derived from the acquisition of the asset though financing<sup>12</sup>.

6.- Article 15 of the Federal Tax Code (Mexico City, December 31, 1981). Last Updated April 23, 2021

7.- In spanish, enajenación de bienes

8.- Article 14 of the Federal Tax Code (Mexico City, December 31, 1981). Last Updated April 23, 2021

9.- Article 25 of the Income Tax Law (Mexico City, December 11, 2019). Last updated April 23, 2021

10.- The original Amount of Investment includes, in addition to the price of the asset, the taxes actually paid for the acquisition or importation, except for the value added tax.

11.- Article 38 of the General Law of Operations and Credit Titles (Mexico City, August 27, 1932). Last Updated June 22, 2018

12.- Article 25 of the General Law of Operations and Credit Titles (Mexico City, August 27, 1932). Last Updated June 22, 201

Financial lease in which lessee acquires the option to buy the equipment should not be confused with operating lease where a purchase option is added upon expiration. In the second, if the sale of the asset is not conducted at the market price of such asset, the Mexican Tax authorities will probably consider a simulated transaction, that should not have been beneficiary of the tax treatment of operating leases.

As an example, the Japanese structure known as operating lease with purchase option (JOLCO), an operating lease for the purpose of accounting and tax benefits, which gives the lessee an option to purchase the aircraft at the end of the lease, or at some point during the lease period, at a price set in the lease. Although it is only an option, it is generally used in practice<sup>13</sup>. In this scenario and in accordance with the Mexican Law, Lessees located in Mexico would probably not be able to benefit from this structure as it would be considered a financial lease unlike in other jurisdictions where operating lease and the financial lease are treated equally for tax purposes.

Is worth mentioning that in the aviation industry, due to the cost of aircraft, deregulation of commercial aviation, reduced levels of governmental financial support to airlines, and reduced capital expenses for their aircraft acquisitions has resulted in airlines looking to procure aircraft from wherever the conditions are most favorable. They therefore seek i) access to capital or financing opportunities from which ever geographical location provides the best terms; ii) access to lease terms and conditions from whichever foreign jurisdiction provides the best terms as opposed to domestic markets and iii) jurisdictions which may provide more favorable tax and accounting benefits than others. As a consequence of the aforementioned, international financial leases or cross-border aircraft lease transactions have become customary in the air transport industry, with lessors usually obtaining funds from financial institutions from different countries and leasing aircraft to airlines in other countries. The above is important because as we were able to see our legislation on financial leases is limited and undeveloped and not always compatible with certain precepts of other jurisdictions, so it would be important to make certain reforms to our law on financial leases.

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13.- Hisao Hirose, Squire Patton Boggs. (2017). *Aviation finance in Japan: overview*. July 26, 2021, de Thomson Reuters: [https://content.next.westlaw.com/2-624-3690?\\_lrTS=20200916051632440&transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://content.next.westlaw.com/2-624-3690?_lrTS=20200916051632440&transitionType=Default&contextData=(sc.Default)&firstPage=true)

**The importance of aviation in Mexican tourism.**

Aviation in Mexican tourism represents 43.6% of the international tourist flow, as stated by Miguel Torruco Marqués, head of the Ministry of Tourism (SECTUR). Aviation generates an economic flow of 1,955 million dollars to Mexico's Gross Domestic Product (GDP); in addition, this branch of the tourism and commercial industry generates close to 35 thousand direct jobs. This is achieved thanks to the national airport network, which consists of 76 airports, 56 of which are international and 20 domestic. These operate 765 different routes and 143 of them connect with 27 countries around the world. The recovery of tourism is expected with the tentative arrival of 26 million 800 thousand international tourists this year. The economic revenue would be 12.2 billion dollars and hotel occupancy would be 43.7 percent. [www.inmobiliare.com/la-importancia-de-la-aviacion-en-el-turismo-mexicano/](http://www.inmobiliare.com/la-importancia-de-la-aviacion-en-el-turismo-mexicano/) July 16, 2021.

**AIFA's budget cut for 2021.**

By 2021, the Secretary of Finance and Public Credit has reduced the budget allocated to the Secretary of National Defense for the construction of the Felipe Angeles International Airport in Santa Lucia, Mexico, from 37,986 million pesos to only 3,780 million pesos, a 90 percent reduction. According to information submitted to the Chamber of Deputies by the Tax Authorities, the airport's construction has cost 18 billion 158 million pesos since it began on October 17, 2019. The President promised in the middle of last year that the Santa Lucia project would cost 80 billion pesos; but, according to a Treasury document, the total amount of investment planned is 84,956 million pesos. [www.a21.com.mx/index.php/aeropuertos/2021/07/21/recortan-presupuesto-de-aifa-para-2021](http://www.a21.com.mx/index.php/aeropuertos/2021/07/21/recortan-presupuesto-de-aifa-para-2021) July 21, 2021.

**Mexico to grow 9.9% by 2025.**

Despite the impact of the crisis caused by the Covid-19 pandemic, the International Air Transport Association (IATA) forecasts that by 2025 the number of passengers transported in Mexico will grow by 9.9%, compared to 2019. This means that, by 2025, Mexico will have a flow of 101 million 950 thousand passengers, a growth of almost 10% compared to what it had in 2019, when it registered 92 million 780 thousand passengers, IATA said. Furthermore, among eleven countries in the Americas, Mexico will occupy the ninth position in terms of growth rate, only ahead of the United States (940 million 750 thousand passengers) and Canada (106 million 780 thousand), which will grow 9.5% and 8%, respectively, by 2025. [www.a21.com.mx/index.php/aerolineas/2021/06/25/crecera-mexico-99-para-2025](http://www.a21.com.mx/index.php/aerolineas/2021/06/25/crecera-mexico-99-para-2025) June 25, 2021.

**Four directors of the Federal Agency of Civil Aviation (AFAC) were removed.**

For the past four months, four directors of Mexico's air transport authority have been removed from their positions. The removal matched with the arrival of Carlos Antonio Rodríguez Munguía, former Air Force commander, as head of the AFAC, who in recent days notified Maricruz Hernández, director of Airports, Guillermo Magaña, director of Aviation, and Román Ramírez, deputy director of Communication, Navigation and Surveillance, that they had to leave their positions for no reason. According to the workers, there is a tense atmosphere in the agency because of this situation, as they do not know if there will be more dismissals in the coming months, and because of the uncertainty as to whether the new directors will replace the staff, as well as speculation that more military personnel will arrive. [www.a21.com.mx/aeronautica/2021/07/22/remueven-cuatro-directores-de-afac](http://www.a21.com.mx/aeronautica/2021/07/22/remueven-cuatro-directores-de-afac) July 22, 2021.

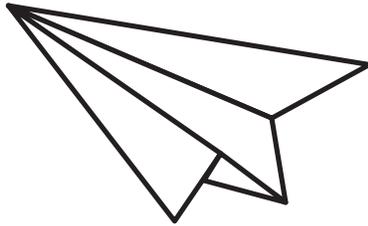
**Mexico's domestic air recovery at 75%.**

Between January and June 2021, Mexican airlines carried 19 million 226 thousand 765 domestic passengers, according to the latest data published by the Secretary of Communications and Transport (SCT). This figure leaves the Mexican industry with a 75% recovery compared to the numbers it had in the first half of 2019, prior to the crisis due to the covid-19 pandemic. However, the recovery has been increasing as the year has progressed. For the month of June alone, Mexican airlines carried three million 834 thousand 253 passengers, at 84% of pre-pandemic figures, while in January they were at 62%. [www.a21.com.mx/aerolineas/2021/07/26/recuperacion-aerea-domestica-de-mexico-al-75-sct](http://www.a21.com.mx/aerolineas/2021/07/26/recuperacion-aerea-domestica-de-mexico-al-75-sct) July 23, 2021.

*In this month extract was prepared by A. Fragoso, P. Arandia, A. De la Fuente, R. Nerio, R. Mancilla, J. García, S. Robles.*

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