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Aircraft leasing in Ireland
Crossing borders

Leading business advisers

Contents

Ireland has long been one of the world's major centres for cross-border aircraft leasing. This is demonstrated by the number of international leasing companies from virtually every major trading nation which have established operations in Ireland.

Why Ireland for Aircraft Leasing?

Nine of the of the world's top 10 leasing companies currently operate in Ireland, with operations spanning the industry value chain, from sales to asset management and technical services.

Over half of the world's leased aircraft is managed out of Ireland.

So, why Ireland?

- Irish government support of the industry and commitment to Ireland remaining the number one country for all leasing activities.
- Highly developed and efficient, pro-business regulatory regime
- Disproportionately high number of world class lease arrangers, asset marketing personnel and legal and tax advisors
- Highly educated, English-speaking workforce
- Low rate of corporation tax, with generous entitlement to expense deductions and capital allowances
- Favourable withholding tax regime

About Deloitte

Deloitte Ireland is a world-class firm of expert business advisers, serving senior business leaders who are seeking to protect and create value in a complex, dynamic environment.

Aircraft leasing market overview

Ireland has long been one of the world's major centres for cross-border aircraft leasing. This is demonstrated by the number of international leasing companies from virtually every major trading nation which have established operations in Ireland.

Ireland offers significant advantages to aircraft leasing operations, including relatively high capital allowance rates and low withholding taxes. The Irish rules on entitlement to capital allowances and the treatment of lease income/expense are relatively generous, providing a favourable result for taxpayers and easily accommodating common international financial structures.

The growth of the industry was nurtured by Ireland's tax incentive regime which was first introduced in the 1950s. The development of the leasing industry was given a major stimulus by the launch in 1987 of the International Financial Services Centre (IFSC) in Dublin. The commitment of the Irish Government to maintain the competitive position of the Irish international services sector has been demonstrated by the move to a 12.5% rate of taxation on actively earned income from 1 January 2003.

A highly developed and efficient regulatory regime exists and leasing transactions are governed by a common law system of commercial law. Ireland is also a member of the European Union and was one of the first accession countries to the EU following its establishment. Furthermore, the general workforce is highly educated, English speaking and one of the youngest in Europe.

Accurate statistics on the size of the aircraft leasing sector in Ireland are difficult to establish. However, it is clear that a large indigenous pool of expertise has been created and Ireland now has a disproportionately high number of world class lease arrangers, asset marketing personnel and legal and tax advisers.

Ireland offers significant advantages to aircraft leasing operations.

Aircraft leasing law and regulation

Regulation of leasing activities

There is no specific regulation of big ticket aircraft leasing activities and lessors in Ireland. However, lessors must comply with general standards of trading laws.

Any entity or individual can operate an aircraft leasing trade in Ireland. Companies are governed by the provisions of the Companies Act, 1963 to 2012, and the authorisation to engage in a leasing activity must be included in the company's Memorandum of Association. Companies registered under foreign laws can also operate freely in Ireland provided they have registered on the external register of companies in Ireland, principally as a branch.

Types of leases recognised by law

There is no specific body of legislation covering the operation of leasing contracts which are governed by general legal standards.

In Irish commercial law there is no distinction made between a finance lease and an operating lease.

Lease documentation requirements

There are no specific rules relating to the content of non consumer lease documentation in Ireland and such documentation resembles that of most of the major law jurisdictions. In the case of consumer hire-purchase agreements or consumer hire agreements, the requirements of the relevant legislation have to be complied with.

Security

A lender that finances the purchase of an asset by an Irish company will normally take security over that asset. A registerable security must be registered at the Companies Registration Office in Dublin. This registration protects a lender's priority against subsequent charges or any receiver or liquidator appointed over the company. Registration must occur within 21 days and can be inspected by the public.

When a security has been drafted and registered, it should result in the secured creditor ranking in priority to unsecured and subsequent security holders. There are, however, situations in Ireland which may affect secured creditors. In some cases, the Revenue Commissioners may claim priority in respect of certain outstanding taxes. The other situation arises as a result of the introduction into Irish company legislation of the concept of examinerships – a concept similar to that of Chapter 11 of the US Bankruptcy Code.

In Irish commercial law there is no distinction made between a finance lease and an operating lease.

Accounting framework for aircraft leases

There are two relevant accounting frameworks for leasing entities reporting in Ireland – IFRS and Irish GAAP.

Irish companies with debt or equity securities listed on a regulated market of any EEA (European Economic Area) State are required by law to prepare their group annual financial statements using International Financial Reporting Standards (IFRS) as adopted by the European Union. An Irish entity not required to prepare IFRS accounts may elect to prepare their financial statements either under IFRS or Generally Accepted Accounting Practice in Ireland (Irish GAAP).

In this brochure we focus on lease accounting for companies preparing accounts under Irish GAAP and also highlight some of the key differences between Irish GAAP and IFRS.

Accounting for leases under Irish GAAP

Under Irish GAAP, leases are accounted for in line with Statement of Standard Accounting Practice 21 (SSAP 21: Accounting For Leases and Hire Purchase Contracts). In addition, regard should also be given to the "Guidance Notes on SSAP 21 Accounting for Leases and Hire Purchase Contracts" issued in August 1984. The overriding principle behind SSAP 21 is for companies to reflect the commercial substance of a lease rather than the legal form. This concept is fundamental in Irish GAAP, and is also dealt with in Financial Reporting Standard 5 (FRS 5: Reporting the Substance of Transactions). FRS 5 requires transactions to reflect substance over form and provides particular guidance in respect of sale and leaseback transactions. Furthermore, the substance over form is also reinforced in Irish law by section 5(f) of the Companies (Amendment) Act, 1986 which requires directors preparing financial statements to have regard to the economic substance of transactions when deciding on the presentation to be adopted in the accounts.

Classification of leases

Under Irish GAAP the substance of a lease transaction depends on which party is exposed to the risks and rewards associated with ownership of the leased asset. If all of the risks and rewards associated with ownership are transferred to the lessee, then the lease is generally regarded as a finance lease for accounting purposes. Otherwise, the lease is generally regarded for accounting purposes as an operating lease. In practice, all leases transfer some of the risks and rewards associated with ownership to the lessee, and accordingly, the distinction between a finance lease and an operating lease is essentially one of degree. SSAP 21 provides guidance on this issue, and contains a rebuttable presumption that the relevant transfer of risks and rewards occurs if, at the inception of the lease, the present value of the minimum lease payments exceeds 90% of the fair value of the asset. A hire purchase contract will generally fall within the definition of a finance lease for accounting purposes and will be accounted for as such. Consequently, a lease contract containing a purchase option may be classified as a finance lease for accounting purposes but as a hire purchase contract from a legal perspective.

Lessor accounting

Operating lease

The aircraft subject to lease, should be recognised in the balance sheet of the lessor as a tangible fixed asset and depreciation charged to the profit and loss account over the useful economic life of the asset on a straight-line basis. However, an alternative basis of depreciation may be used if this is more representative of the time pattern in which the benefit of the aircraft is receivable.

Rental income from an operating lease, excluding charges for services such as insurance and maintenance, should be recognised on a straight-line basis over the period of the lease, even if the payments are not made on such a basis, unless another systematic and rational basis is more representative of the time pattern in which the benefit from the aircraft is receivable.

Finance lease

The aircraft should not be capitalised in the balance sheet of the lessor. Instead, the amount due under the lease should be recognised in the balance sheet as a lease receivable at the amount of the net investment in the lease, after making provision for bad and doubtful rents receivable.

The lease is effectively re-characterised as the purchase of aircraft by the lessee financed by a loan. Accordingly, the lessor should treat the rental receipts under the lease as part capital repayments and part finance income. The finance income should be allocated to accounting periods so as to give a constant periodic rate of return on the lessor's net cash investment in the lease.

Lessee accounting

Operating lease

The aircraft should not be capitalised in the balance sheet of the lessee. Lease rentals should be charged to the profit and loss account on a straight-line basis over the term of the lease, unless another systematic and rational basis is more appropriate.

Finance lease

The aircraft under lease should be recognised in the balance sheet of the lessee together with a corresponding liability. The value of the asset and liability should equal the present value of the minimum lease payments. The aircraft should be depreciated over the shorter of the lease term and the useful economic life of the asset. The lessee should treat the lease rentals as part capital repayment and part finance charge. The repayment of capital should be set against the outstanding liability in the balance sheet. The finance charge should be allocated to the relevant accounting periods so as to give a constant periodic rate of charge on the remaining liability.

Sale and leaseback

The accounting treatment of a sale and leaseback transaction depends upon whether the leaseback is classified as a finance lease or an operating lease.

Sale and operating leaseback

If the leaseback is classified as an operating lease, then the vendor (the lessee) has disposed of substantially all the risks and rewards associated with ownership of the asset.

Consequently, the lessee is treated as having disposed of the aircraft for accounting purposes and then subsequently leased it back under a separate transaction. The precise accounting treatment depends upon whether the transaction is carried out at fair market value. If it is clear that the sale price is established at fair market value, any profit or loss on the sale should be recognised immediately in the profit and loss account of the lessee. If the sale price is above fair value, the excess over fair value should be deferred to the balance sheet and then amortised through the profit and loss account over the shorter of the remainder of the lease term and the period to the next rent review (if any). If the sale price is below fair value, any deficit should be recognised immediately.

However, if the apparent loss is compensated by future lease rentals at below market price, it should be deferred to the balance sheet and amortised through the profit and loss account over the remainder of the lease term (or, if shorter, the period over which the reduced rentals are chargeable).

The subsequent operating leaseback should be accounted for as described above.

Sale and finance leaseback

If the leaseback is regarded as a finance lease for accounting purposes, then the lessee has effectively re-acquired substantially all the risks and rewards associated with ownership of the asset.

The lessee is treated as never having disposed of the aircraft and the transaction is treated as the raising of finance secured upon the asset. Accordingly, the aircraft should remain on the balance sheet of the lessee and continue to be depreciated. The sales proceeds received from the purchaser (the lessor) should be capitalised as cash, together with a corresponding liability.

Lease incentives

UITF Abstract 28 “Operating lease incentives” (Issued 22 February 2001) confirms that, whatever form they may take, any benefits received and receivable by a lessee as an incentive to sign a lease should be treated as a reduction of rental expense. The benefit should be spread on a straight-line basis over the shorter of the lease term and the period until a review date on which the rent is first adjusted to the prevailing market rate. Similarly the lessor should recognise the cost of the incentive as a reduction of rental income again over the lease term or the expected term until prevailing market rental will be paid.

International financial reporting standards
Comparison with Irish GAAP

International Accounting Standard 17 "Leases" has much in common with its Irish GAAP counterpart, SSAP 21: Accounting for Leases and Hire Purchase Contracts. However, there are certain important differences that may have a pronounced impact for companies moving to IFRSs from Irish GAAP. Some of the significant differences between the two standards are highlighted below:

Area	Description of difference
Coverage of standard	IAS 17 relates to leases whereas SSAP 21 relates to leases and hire purchase contracts. A hire purchase contract has similar features to a lease except that under a hire purchase contract the hirer may acquire legal title by exercising an option to purchase the asset upon fulfilment of certain conditions (normally the payment of an agreed number of instalments). IAS 17 specifically excludes the following from its scope: • leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources; and • licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights. SSAP 21 does not exclude the above transactions from its scope.
Quantitative test for finance lease	Both standards use a similar definition for finance leases. SSAP 21 places considerable emphasis on the quantitative test of present value of minimum lease payments (also called the 90% test). However, IAS 17 does not include a quantitative test. Instead it provides additional guidance as to when a lease should be classified as a finance lease.
Accounting for incentives offered by lessors in an operating lease	In negotiating an operating lease, the lessor may provide incentives for the lessee to enter into the agreement. Examples of such incentives are an up-front cash payment to the lessee or the reimbursement or assumption by the lessor of costs of the lessee. Alternatively, initial periods of the lease term may be agreed at a reduced rent. SIC 15 distinguishes between incentives and the initial cost of an operating lease. The latter is amortised over the period of the lease while the former is expensed in the period in which these are incurred. Under the UK equivalent, UITF 28, lessors should recognise the aggregate cost of incentives as a reduction of rental income. The cost of the incentives should be allocated over the lease term or a shorter period ending on a date from which it is expected the prevailing market rental will be payable.
Accounting of lease income under finance lease by lessors	IAS 17 and SSAP 21 provide different approaches to recognising income under finance leases. SSAP 21 allows the lessors to use either the Net Investment Method or the Net Cash Investment method whereas IAS 17 permits only the Net Investment Method.
Disclosures	Disclosures required by IAS 17 are more detailed compared to those required under SSAP 21. An example of the detailed disclosures required under IAS 17 for finance leases in the financial statements of the lessor is to provide a reconciliation between the gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date.

Future developments

IASB/FASB Exposure Draft on leases

In response to the criticism from different stakeholders, the IASB and the FASB jointly started a project to overhaul the existing accounting for leases and issued an exposure draft in August 2010 and a revised exposure draft recently in May 2013. The existing accounting standard on leases, IAS 17, has been criticised for failing to meet the needs of users of the financial statements. Critics argued that only a small portion of leases are actually reported on a lessee's balance sheet, not reflecting the true extent of the lessee's obligations. As a result many analysts and investors compensate for the perceived shortfalls of IAS 17 by making standard adjustments to reflect the obligations for future operating lease payments.

The proposals in the revised exposure draft require reporting entities to recognise almost all leased assets and liabilities on their balance sheet, with some exceptions, and thereby eliminate the distinction between operating and finance leases that we currently have. The drive to move operating leases on-balance sheet is based on a rationale that leases are a form of off-balance sheet financing which creates hidden leverage and many hold the view that it is important that regulators and investors are able to understand the true leverage of a business which includes leasing and similar arrangements.

The decision of the IASB to expose its revised proposals on lease accounting affords interested parties the opportunity to consider and to comment (the comment period ended on September 13, 2013).

The future of Irish GAAP

Irish companies generally prepare their financial statements on one of two bases: IFRSs or existing Irish standards. But this is about to change. Current Irish accounting standards are to be replaced with FRS 102, a new, much shorter standard, based on the IFRS for SMEs. In addition, a new option for some companies to follow the recognition and measurement bases of IFRSs, but with reduced disclosures, has been introduced by FRS 101.

The accounting options in a nutshell

	IFRS	FRS 101 (IFRS with reduced disclosures)	FRS 102 (Replacement for current Irish GAAP)	FRSSE
Listed group consolidated financial statements	✓			
AIM/ESM group consolidated financial statements	✓			
Listed company individual financial statements	✓	✓*	✓	
AIM/ESM company individual financial statements	✓	✓*	✓	
Unlisted group consolidated financial statements (of all sizes)	✓		✓	
Unlisted company individual financial statements of large and medium-sized companies	✓	✓*	✓	
Unlisted company individual financial statements of small companies	✓	✓*	✓	✓

*FRS 101 is available for individual financial statements only where the entity meets the definition of a "qualifying entity"

The new regime will be mandatory for periods beginning on or after 1 January 2015, although companies can apply the new standards early.

Specifically regarding leases, the new Irish GAAP seek to align the treatment of leases more closely with IAS 17 and remove a number of the differences outlined above.

Direct taxation of leases

Overview of corporate tax regime

A company resident in Ireland pays corporation tax on its profits (income and chargeable gains) wherever they arise. A non-resident company trading through a branch or agency in Ireland pays corporation tax on the profits connected with that branch or agency. If the non-resident company has no branch or agency in Ireland, it is liable to income tax on Irish source income and to capital gains tax on disposal of certain specified Irish assets. A company is resident in Ireland if it's central management and control is in Ireland. Furthermore, subject to certain exceptions, a company incorporated in Ireland on or after 11 February 1999 is deemed to be resident in Ireland for tax purposes.

Corporation tax is chargeable in respect of the taxable profits of a company for an accounting period, not the calendar year. A tax accounting period can never exceed 12 months. The starting point for calculating taxable profits is the profit disclosed in the company's financial statements. This must then be adjusted for tax purposes. Generally, expenses are deductible for tax purposes if they are incurred wholly and exclusively for the purposes of the trade and are not of a capital nature.

One of the best known features of the Irish tax system has been the low rates of corporation tax. Low incentive rates have existed in various guises since the 1950s. In the past a 10% rate of corporation tax had been available for cross-border leasing companies operating from Dublin's IFSC or from the Shannon region in south western Ireland. However, it is no longer possible to establish new leasing operations under either of these incentive regimes, and all new leasing companies will be subject to standard Irish corporation tax rates (see below). As the IFSC/Shannon regime is not applicable from 2006, commentary on the special tax rules which apply to trades operating from these zones is not included in this document.

The Irish authorities have responded to the removal of the special tax regime through the introduction of the 12.5% corporation tax rate which applies to trading profits arising from active Irish businesses with effect from 1 January 2003. General leasing activities should qualify as active businesses. However, the leasing of immoveable property is likely to be subject to the passive corporate rate of tax which is 25%.

One of the best known features of the Irish tax system has been the low rates of corporation tax.

Active versus passive

The lower tax rate of 12.5% applying to corporate profits only applies where the lessor is regarded as being engaged in a trade of leasing. Otherwise a higher rate of 25% would apply to the taxable profits generated from a lease. Whether a trade exists or not is not defined in Irish tax legislation. The Irish Revenue have indicated that in analysing this question they will closely consider the commercial rationale for the activity in Ireland, the substance of the operation, whether value is added in Ireland and the number and experience of employees operating in Ireland. The question of whether or not a trade exists is also the subject of a large body of case law. As a general guide, however, where a number of leases are entered into with a view to making a profit from the leasing activity and the management of the activity is carried out from Ireland, the activity should amount to a trade in Ireland. It is usually possible to obtain trading treatment for leasing activities, even in circumstances where there is a single lease.

The introduction of the 12.5% tax rate has been specifically agreed with the EU. As this rate now applies to all active businesses in Ireland, it does comply with EU competition rules.

Ireland has no controlled foreign company legislation or formal thin capitalisation rules. Ireland has introduced general anti-avoidance legislation, as well as certain specific anti-avoidance provisions.

Most cross-border leasing companies based in Ireland will expect to make tax losses in the first few years of operation due to the existence of favourable tax depreciation rates.

Tax depreciation

Accounting depreciation is not a deductible expense for tax purposes. However, tax depreciation, known as capital allowances, may be available in respect of certain assets. The treatment of capital allowances is crucial for any leasing operation. The standard rate of capital allowances for aircraft, plant and machinery in Ireland is 12.5% calculated on a straight line basis over eight years. This rate can be claimed for any aircraft that is in use in the leasing trade at the end of the accounting period.

Capital allowances are available on industrial buildings on a straight line basis at a rate of 4%.

Finance Act 2013 introduced a scheme of accelerated industrial buildings allowances for the construction or refurbishment of buildings or structures used for the purposes of the maintenance, repair or overhaul of commercial aircraft or the dismantling of such aircraft for the purposes of salvaging or recycling the parts or materials. The allowances may be claimed in respect of qualifying construction or refurbishment expenditure incurred in the five year period commencing on the date of the passing of the Finance Act 2013, and allowances are granted over a seven year period. The extension of the scope of industrial buildings allowances in this way provides further indication of the commitment of the Irish Government to the development of the aviation sector.

Entitlement of lessor to capital allowances

The Irish rules regarding a lessor’s entitlement to capital allowances can be quite flexible. In particular situations, it may be possible for the lessor to claim capital allowances on the basis of either legal or economic ownership of an asset. In general, capital allowances may only be claimed by one party to the leasing transaction, where both the lessee and lessor are Irish tax resident.

The accounting treatment will not determine a lessor’s entitlement to capital allowances. However, the legal structure and documentation of a lease transaction can be influential.

In particular situations it may be possible to obtain an advance Revenue ruling on the issue of entitlement to capital allowances.

Utilisation of leasing tax losses

Provisions contained within the Taxes Consolidation Act 1997 restrict the use of capital allowances on leased assets that are in excess of the amount needed to cover leasing profits. The provisions effectively “ring fence” the excess capital allowances by providing that they cannot be used to shelter profits other than those of the leasing trade to which they relate.

Further provisions of the Taxes Consolidation Act “ring fence” capital allowances on assets in certain “balloon leases”. Broadly, the offending leases are ones where the lease rentals are staggered towards the end of the lease with a view to deferring taxation. Detailed criteria are laid down and if these are breached, the capital allowances may only be offset against income from that particular asset.

Double dip leasing

In cross-border leases it can sometimes be possible to achieve a "double dip" of capital allowances, that is, where capital allowances can be claimed by more than one party to the transaction. This is possible because of different rules in different countries on entitlement to tax depreciation. Some countries have a legal ownership test for determining entitlement to tax depreciation; other countries have an economic ownership test, whilst others have a test based on a mix of economic and legal ownership. In general, the Irish rules are a good fit with other jurisdictions' rules and a double dip is therefore often possible.

Taxation of the lessor

Adjustments to accounting results may be required in order to restate a lessor's profits for tax purposes. There are four broad possibilities in relation to plant and equipment leasing, please see below:

(i) Accounting operating lease – lessor entitled to capital allowances.

In this case the lessor's tax treatment will generally be straightforward:

- The full lease rental should generally be taxed in the same period as it arises in the financial statements. Accounting principles on the timing of the recognition of lease income will be particularly influential in the case of a trading lessor.
- The accounting depreciation on the asset will be disallowed for tax purposes and capital allowances will be claimed instead.

(ii) Accounting operating lease – lessor not entitled to capital allowances

In the case of aircraft leasing, this scenario is unlikely to arise in practice since it is usually possible to demonstrate the lessor's entitlement to capital allowances in these circumstances on the grounds of either economic or legal ownership. In rare cases where this does arise, the lessor's tax treatment will generally reflect the following:

- The full lease rental should generally be taxed in the same period as it arises in the financial statements. Accounting principles on the timing of the recognition of lease income will be particularly influential in the case of a trading lessor.
- No deduction will be available for depreciation on the asset.

(iii) Accounting finance lease – lessor entitled to capital allowances.

This is the most common scenario for tax based leases. In this scenario, the accounting treatment does not provide much guidance as the tax and accounting treatments are so different. The lessor is treated as the owner of the asset for tax purposes but not for accounting purposes. In this case:

- The lessor claims capital allowances on the asset.
- The full lease rental (and not just the interest element reflected in the profit and loss account) should be included as taxable income.
- The question arises as to how much of the lease rentals should be taxed in each particular accounting period. A common practice has been to tax the amount of lease rental receivable in each period. This gives rise to the possibility of structuring long life leases with the capital element of lease rentals staggered towards the end of the lease in order to give a tax deferral, sometimes called a balloon lease (discussed above). Some lessors have agreed with the Revenue to follow an accruals basis for the recognition of lease income under this scenario.

(iv) Accounting finance lease – lessor not entitled to capital allowances

In this situation the transaction is similar to a loan for accounting purposes. In particular cases it may be possible to agree that the tax treatment should follow the accounting treatment. Generally, this means taking the interest element of the lease rentals to the profit and loss account over the life of the lease.

(v) Leases of Short Term Assets

Section 80A provides for an alternative mechanism for taxing lessors of short-life assets, subject to satisfying a number of conditions. Broadly speaking, Section 80A allows the lessor to follow the accounting treatment in calculating the leasing profits subject to corporate tax. In such circumstances, capital allowances will not be claimed, but accounting depreciation will be deductible, where relevant.

In summary, Section 80A broadly applies to leases of plant or machinery (including aircraft), which has an expected useful life of less than 8 years. It was first introduced for Finance Leases, and in Finance Act 2010 was extended to cover operating leases.

An election must be made in the Corporate Tax Return in order to follow the Section 80A treatment.

Finance leases

This will result in the "interest" element only of the lease payments being charged to tax and no capital allowances will be claimed.

Operating leases

Following the enactment of the Finance Act, 2010 a lessor can elect to claim capital allowances which equate to the accounting depreciation for the period in respect of certain short life assets and to be taxed on the lease rental, subject to the application of certain threshold limits.

Gains on the sale of assets

There are two broad types of gain on the sale of a leased asset for tax purposes, and these are considered below:

(i) Gains where sales proceeds do not exceed original cost of asset.

For example, assume an aircraft was bought for €10 million four years ago. Capital allowances of €5 million have been claimed and, therefore, the asset's tax written down value is now €5 million. It is sold today for €8 million. In tax terms this represents a gain of €3 million over the tax written down value. This gain is treated as a "balancing charge", that is, recapture of previously granted capital allowances. This is like a negative capital allowance and will simply be treated as part of normal income in the leasing trade's tax computation.

(ii) Gains where sales proceeds exceed original cost of asset.

In this case the gain will be split into two portions:

- A recapture of capital allowances previously granted on the asset, equal to the original cost less the current tax written down value. This will be treated as discussed above.
- A gain over original cost.

The treatment of the latter gain is more complex.

There are two broad possibilities:-

(a) Capital gain

In this case a tax rate of 33% should apply. Indexation relief (for periods of ownership up to 31 December 2002 only) should be available to reduce the gain for the effect of inflation over the period of ownership.

(b) Trading gain

In this case the standard Irish corporation tax rate (12.5%) should apply and indexation relief would not be available.

The terms of Irish domestic law and relevant double taxation agreements generally provide credit relief to the Irish lessor for any foreign tax paid.

Taxation of the lessee

The tax treatment of the lease rental expenses will mirror the treatment of lease income discussed above in relation to the taxation of the lessor. In most cases this is relatively straightforward for the scenarios described at (i), (ii) and (iv). Generally, the lessee should be entitled to a tax deduction for the total amount of the lease rentals recognized for accounting purposes. For scenario (iii), which is common for domestic leases, the Revenue will generally give a deduction for lease rentals on an even basis over the primary lease term.

Leasing – Section 110 TCA 1997

One key development in the tax treatment of Irish resident lessors in recent times has been the extension of Ireland's widely used securitisation regime to include leasing transactions. This regime can provide a highly tax efficient result for big-ticket lessors, without the requirement to meet the substance requirements required by the trading regime.

Section 110 of the Taxes Consolidation Act 1997 ("S.110")details the tax law governing the regime. An Irish S.110 company is an Irish resident "qualifying company" which holds "qualifying assets". The Irish company has access to Ireland's extensive tax treaty network. The regime is further beneficial as it provides a platform to engage in financial (and now leasing) transactions in a tax efficient manner using a cost effective structuring of activities.

The definition of "qualifying assets" was expanded in Finance Act 2011 to include plant & machinery, which includes aircraft. It is now specifically legislated for a qualifying company to engage in a business of aircraft leasing. This significantly improves Ireland's offering in the leasing space.

Leasing S.110 companies are taxed as follows in Ireland:

- Subject to corporation tax at 25% on tax adjusted profits, including the rental from lessees.
- Entitled to the same tax deductions for expenses and capital allowances as those afforded to trading lessors (as outlined above);

One of the key advantages of S.110 is that a qualifying company can issue profit participating debt and, subject to certain conditions being satisfied, the interest on that debt is deductible for corporate tax purposes for the company. Furthermore, as a S.110 company is not required to be actively carrying on a trade in Ireland in order to qualify for the above tax treatment, this should also simplify the substance requirements for the Irish company.

In order to qualify as a S.110 company, the Irish company must acquire qualifying assets (e.g. aircraft) to the value of at least €10,000,000 on the first day on which it acquires such qualifying assets. This is a "Day 1" test only, and there is no requirement for the company to continue to hold €10m worth of assets throughout its life.

Outbound leasing

Taxable presence in overseas jurisdiction

In certain circumstances, an Irish lessor may create a taxable presence in the jurisdiction of the overseas lessee. Generally, if the overseas lessee is resident in a jurisdiction with which Ireland has a double taxation treaty, this will only be the case if the Irish lessor carries on business through a permanent establishment in that jurisdiction.

The terms of Irish domestic law and relevant double taxation agreements generally provide credit relief to the Irish lessor for any foreign tax paid. Finance Act 2007 included provisions to allow unilateral credit relief for foreign tax suffered by a company that has a trading branch or agency in a country with which Ireland does not have a double tax treaty. This favourable inclusion allows the Irish company to reduce its Irish corporation tax liability by the foreign tax suffered on the profits of any branch or agency. Up until the changes enacted in 2007, the company would only have been entitled to a deduction for the foreign tax in respect of non-treaty countries (which is much less beneficial than a credit).

The Act also introduced pooling in the case of foreign branch profits. Where the foreign tax on branch profits in one country exceeds the Irish tax on those profits, the provisions allow the surplus foreign tax to be credited against Irish tax on profits from another foreign branch in the year concerned.

However, unlike the foreign dividend provisions, if the surplus is not used in the year it arises, it may not be carried forward to future years. These provisions have benefitted existing Irish companies that have foreign branches located in many foreign jurisdictions as well as improving the attractiveness of Ireland as a location for new headquarter operations.

Foreign withholding taxes

Where an Irish lessor has no taxable presence in the jurisdiction of the overseas lessee, the lease rentals may be regarded as source income in the overseas jurisdiction and subject to withholding tax. Generally, if the overseas lessee is resident in a jurisdiction with which Ireland has a double taxation treaty, then the terms of that treaty may reduce or eliminate the amount of tax withheld. Irish domestic law provides for foreign tax credit relief for irrecoverable withholding tax suffered on lease rentals from double tax treaty countries, and also from countries which do not have a double tax treaty with Ireland. Double taxation relief is allowed by way of a tax credit against the Irish corporate tax payable on the leasing income in question, and is limited to the amount of that Irish tax.

It is important to understand that an Irish lessor will often be in a low tax paying position. Accordingly, an Irish lessor may not be able to obtain significant value from a tax credit for foreign tax paid.

Finance (No.2) Bill 2013 included an enhancement to the foreign tax credit regime applicable to leasing, and allows a company to carry forward any unutilised excess foreign tax credits to future periods.

Where an Irish lessor has no taxable presence in the jurisdiction of the overseas lessee, the lease rentals may be regarded as source income in the overseas jurisdiction and subject to withholding tax.

Inbound leasing

Irish permanent establishment

It is unlikely that a foreign company leasing in Ireland with no local presence should constitute a permanent establishment in Ireland.

Irish withholding taxes

Ireland does not operate a withholding tax on lease rental payments from Ireland. Other Irish withholding taxes can usually be reduced to nil and rarely cause any difficulty. There is an exemption from withholding tax on interest paid to companies in EU or treaty locations, provided the other country imposes tax that generally applies to foreign source interest. There is also an exemption from withholding tax on dividends paid to companies which are either resident in or controlled from EU or treaty locations.

In particular situations where it looks as if outbound withholding tax could be an issue, it is often possible to eliminate the issue through appropriate planning.

Indirect taxation of leases

Domestic leases

The financing of an asset is regarded as a supply of services where there is no specific clause passing ownership in the financed asset to the customer. A clause giving ownership in the asset to the customer renders the supply to be that of goods. In the absence of such a clause, no distinction is made between a finance lease and an operating lease. The rate of VAT applicable to a lease transaction follows the rate applicable to the underlying asset.

Most assets are generally liable to the standard rate of VAT of 23%. However, short-term hiring of certain means of transport (including aircraft) can be liable to VAT at 13½%. The leasing of aircraft to qualifying international airlines is zero-rated (VAT at 0%) (qualifying aircraft).

Whether or not Irish VAT is chargeable on the lease rentals, the lessor is entitled to deduct all of the VAT incurred on acquisition of the asset and related costs.

Cross-border leases

When considering the liability of cross-border leases, the liability of the lease rentals will depend on the consideration of a number of criteria such as the intended use of the asset by the lessee, the country of use, and whether the foreign lessee has been granted any specific approval by the Irish Revenue.

Means of transport

As seen above, certain means of transport can be zero-rated in their own right (e.g. qualifying aircraft). In the case of other means of transport Irish VAT at 23% applies (13.5% for short-term hire). For aircraft, Irish VAT is not charged on lease payments where:

(i) the aircraft is used by an airline flying chiefly on international routes (as defined), or

(ii) the aircraft is effectively used and enjoyed outside the EU.

Where neither (i) nor (ii) above apply and so Irish VAT is chargeable on the lease rentals, a domestic lessee using the aircraft for wholly deductible purposes should be able to obtain a refund of the Irish VAT under its Irish VAT returns.

Ireland does not operate a withholding tax on lease rental payments from Ireland. Other Irish withholding taxes can usually be reduced to nil and rarely cause any difficulty.

The acquisition of aircraft can give rise to a local charge to VAT (or similar indirect tax), e.g. in a purchase and leaseback scenario.

VAT grouping

Where the Irish lessor has related companies established in Ireland, perhaps special purpose aircraft owning and leasing vehicles, it might be possible to achieve a VAT benefit (if not an administrative benefit) for the corporate group by including all of the Irish established entities within a single group VAT registration. This needs to be carefully examined based on the facts of each particular case.

Treatment in other countries

Irish lessors need to appreciate that they may have VAT (or similar indirect tax) obligations in either the lessee's country or the country where the asset is located (if different from the lessee's country). While the terms and conditions of the lease agreement may constitute a supply of leasing services under Irish VAT law, those same terms and conditions could constitute a supply of goods in the lessee's country depending on where the lessee's fiscal authority believes the economic ownership in the asset rests. If the fiscal authority takes the view that the economic ownership passes from the Irish lessor to the lessee, the Irish lessor may be deemed to supply the leased asset in the lessee's country. This could give the Irish lessor a foreign VAT registration liability and an obligation to account for foreign VAT.

In other circumstances, the fiscal authority in a non- EU country could impose a form of withholding VAT on the lease rentals paid by a non-EU lessee to the Irish lessor. Other fiscal authorities could treat leases of assets as falling within the scope of their own VAT (or similar indirect tax) regime where the asset is physically located in their jurisdiction, irrespective of the country of location of the lessee. Again, this could give the Irish lessor an obligation to register for and account for foreign VAT.

Asset disposal and other charges

The acquisition of an asset can give rise to a local charge to VAT (or similar indirect tax), e.g. in a purchase and leaseback scenario. Such foreign VAT may be refundable but such refund claims can be costly in terms of administrative obligations and the Irish purchaser would need to be prepared to finance any VAT paid on the purchase price for a considerable period while the VAT refund process progresses.

The disposal of a leased asset on the termination of a lease is generally regarded as a supply of goods and VAT could be charged on the sale. The location of the asset at the time of sale could also give the Irish owner/lessor foreign VAT liabilities. Where there is a remarketing agreement under which the lessee will market the asset once the lease has expired and identify a purchaser, any "commission" retained by the lessee from the sale proceeds needs to be considered to determine whether such a payment is a rebate on rentals paid to date or consideration for a marketing or other service. Other payments made by a lessee under the lease (e.g. aircraft maintenance reserve payments) would also need to be considered to determine whether Irish or foreign VAT is likely to be an issue.

Statistical reporting

Depending on the leased asset, EU based lessees may be required to self-assess local VAT on the value of the lease rentals payable to Ireland and, as such, Irish lessors will be required to complete and file a statistical return with the Revenue (the VIES return) detailing the value of the lease rentals payable by each EU lessee together with each lessee's local VAT registration number. Each EU tax authority will have access to the Irish lessor's VIES return and by cross-checking the VAT registration numbers on the return they can verify that each local EU lessee has correctly self-assessed for VAT on the lease rental payable. The onus rests with the Irish lessor to notify Revenue of its VIES filing obligation.

Purchasers of aircrafts and ships within the EU may also have Irish intrastat reporting requirements even in circumstances where the acquired aircraft or ship never enters Ireland or its territorial airspace or waters.

Deloitte's VAT experts are available to identify and advise on the VAT efficient methods available to minimise the potential charge to VAT on the asset acquisition and disposal, the Irish and foreign VAT treatment of operational lease structures, on day-to-day operation and management issues, and any statistical reporting requirements.

Stamp duty/transfer tax

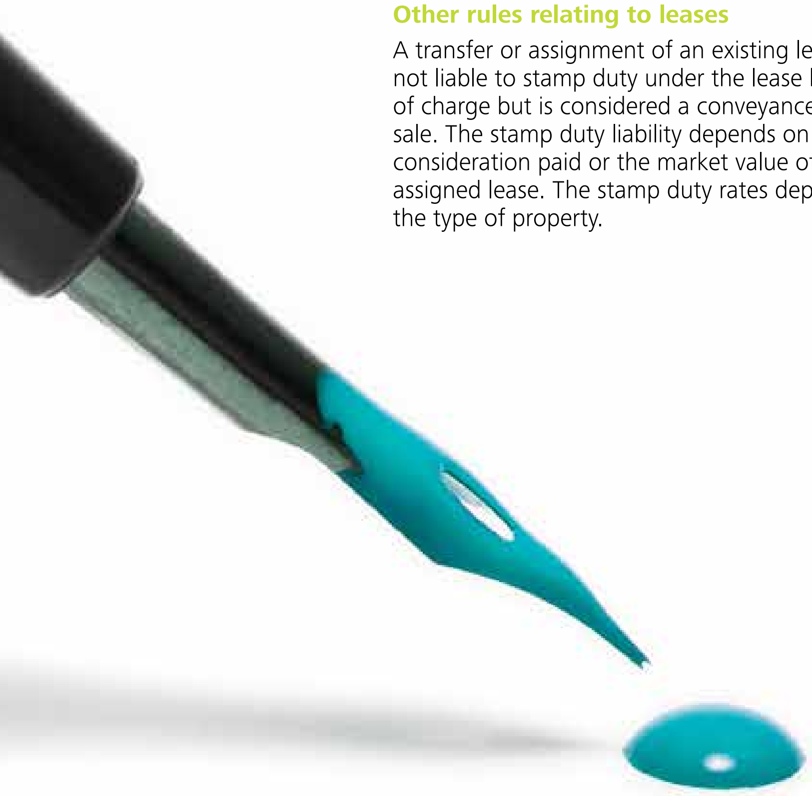
The sale, transfer or other disposition of any part, share or property of or in any aircraft is specifically exempt from Irish stamp duty. In addition, there is a stamp duty exemption for qualifying intellectual property. This exemption includes any goodwill directly attributable to such intellectual property.

Grant of leases

Stamp duty is chargeable on the creation of new leases. However, the lease head of charge only applies to the lease of land or buildings. It does not apply to leases of plant or moveable property such as aircraft, which as a result means such leases are not liable to stamp duty.

Other rules relating to leases

A transfer or assignment of an existing lease is not liable to stamp duty under the lease head of charge but is considered a conveyance on sale. The stamp duty liability depends on the consideration paid or the market value of the assigned lease. The stamp duty rates depend on the type of property.



Deloitte knows the aircraft leasing industry

Deloitte Ireland has a long established, diverse client base of aircraft leasing companies. We are delighted to work with some of the largest and most prominent leasing companies located in Ireland. We are highly regarded by our current aircraft leasing clients in the field of tax, audit, and advisory having been actively involved in providing these services to the aircraft leasing industry over the last number of decades.

Appendix

Summary of Irish taxation

1. Corporation tax rate (on active income)12.5%

2. Standard rate of VAT 23%

3. Transfer taxes Irish stamp duty on non-residential property: 2%

4. Tax depreciation

Type of Asset	Rate	Method	Tax Life Write Off
Plant and machinery	12.5%	Straight Line	8 years
Passenger motor Vehicles – non taxi/ car hire	12.5%**	Straight line	8 years
Industrial buildings Allowance	4% - 15%	Straight line	7 - 25 Years

5. Withholding taxes on rental payments

Ireland does not operate a withholding tax on lease rental payments from Ireland.

*** Subject to a restriction by reference to the cost of the vehicle and its CO2 emissions.*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Départs

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