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Regional tax update

Airline Economics Growth Frontiers Dubai 2018

3 October 2018

Agenda

1. Overview of tax update in the GCC states
2. Regional tax update
3. Outlook for Bahrain, Oman, Qatar & Kuwait on VAT matters
4. The MLI and its impact for lessors
5. Q&A

Overview of tax update in the GCC states

Kuwait:

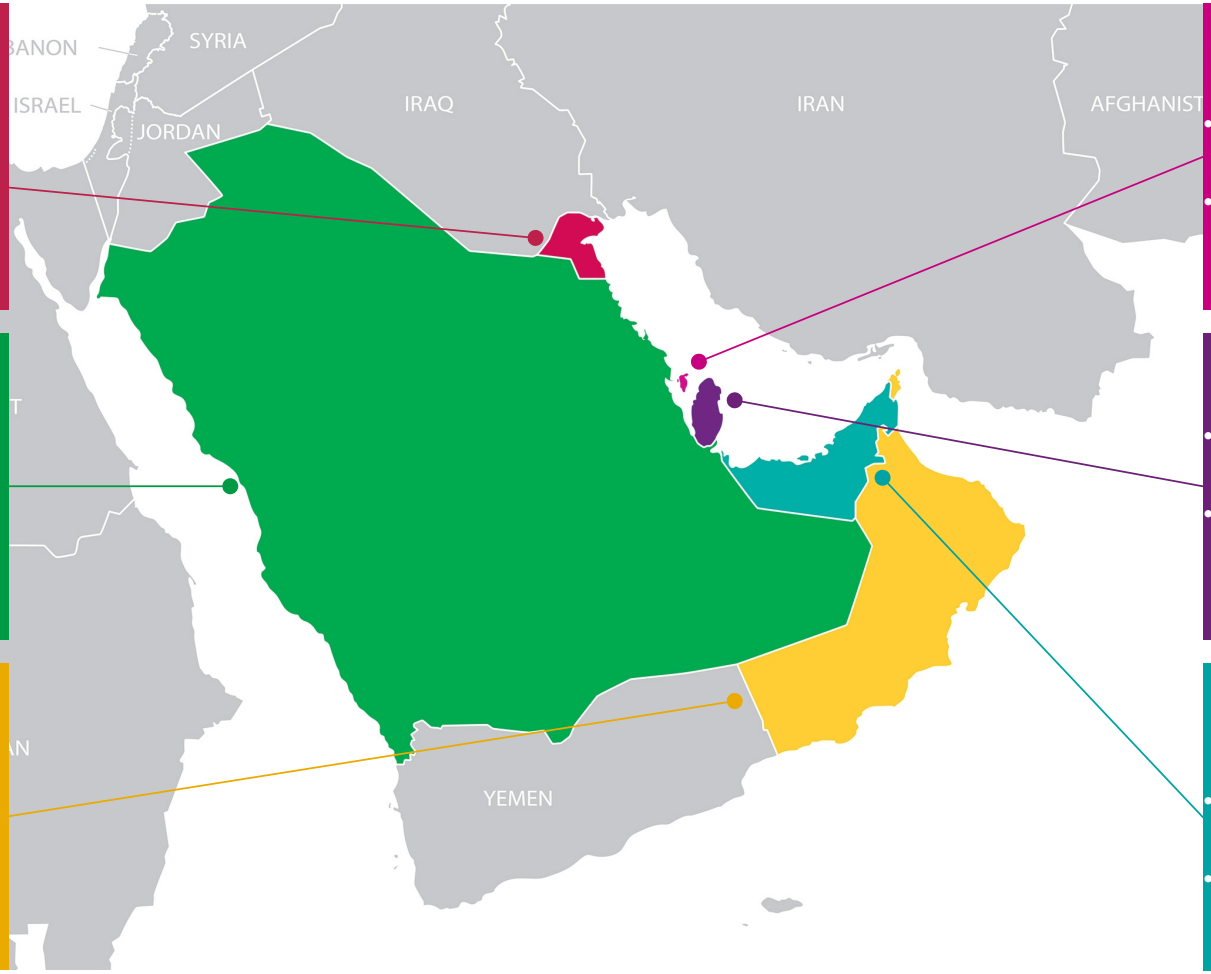
- No VAT – expected from 2021
- Signed the MLI on 7 June 2017 but no formal guidance on ratification has been issued

Saudi Arabia:

- VAT applied from 1 Jan 2018
- Not a signatory to the MLI but has committed to signing the MLI

Oman:

- No VAT – expected from 2019
- Not a signatory to the MLI but has committed to signing the MLI



Bahrain:

- No VAT – expected from 2019
- Not a signatory to the MLI

Qatar:

- No VAT – expected from 2019
- Not a signatory to the MLI but has committed to signing the MLI

UAE:

- VAT applied from 1 Jan 2018
- Signed up to the MLI

UAE

VAT on transfers

— VAT was introduced in the UAE with effect from 1 January 2018.

— A supply of goods or services is subject to VAT in the UAE.

— Standard rate of VAT is 5% unless it is specifically zero rated, exempted or considered as provided outside the scope of UAE VAT.

— Possible exemption if aircraft / engine is located in a Designated Zone.

— Zero-rate of VAT should be available where the aircraft / parts are of a kind designed for commercial transportation of goods and passengers.

— Seller is technically obligated to register for UAE VAT but can submit an application for exemption from registration for UAE VAT on the basis that it only makes zero rated supplies in the UAE.

VAT on leasing

— The lease of an aircraft / engine should be subject to UAE VAT.

— Zero rating available for the lease of aircraft / engines.

— Reverse charge mechanism available whereby the lessee should be responsible to self account for any UAE VAT arising on the lease of an aircraft / engine.

— The non-resident lessor should have no obligation to register for UAE VAT.

MLI

— Signed the MLI on 27 June 2018.

— Expected to be ratified in 2019.

Saudi Arabia

VAT on transfers

— VAT was introduced in Saudi Arabia with effect from 1 January 2018.

— A supply of goods or services is subject to VAT in Saudi Arabia.

— The transfer of goods (i.e. aircraft and engines) in Saudi Arabia should be chargeable to VAT at the rate of 5%.

— However, the supply of “qualifying means of transport” may be zero rated.

— Seller is technically obligated to register for Saudi VAT but should be exempt from this obligation to register on the basis that it only makes zero rated supplies in Saudi Arabia.

VAT on leasing

— Zero rating available for the lease of aircraft / engines.

— Reverse charge mechanism available whereby the lessee should be responsible to self account for any UAE VAT arising on the lease of an aircraft / engine.

MLI

— The Saudi Arabian cabinet authorized the Minister of Finance to sign the MLI on 17 July 2018. More developments are expected over the coming months.

Outlook for Bahrain, Oman, Qatar & Kuwait on VAT matters

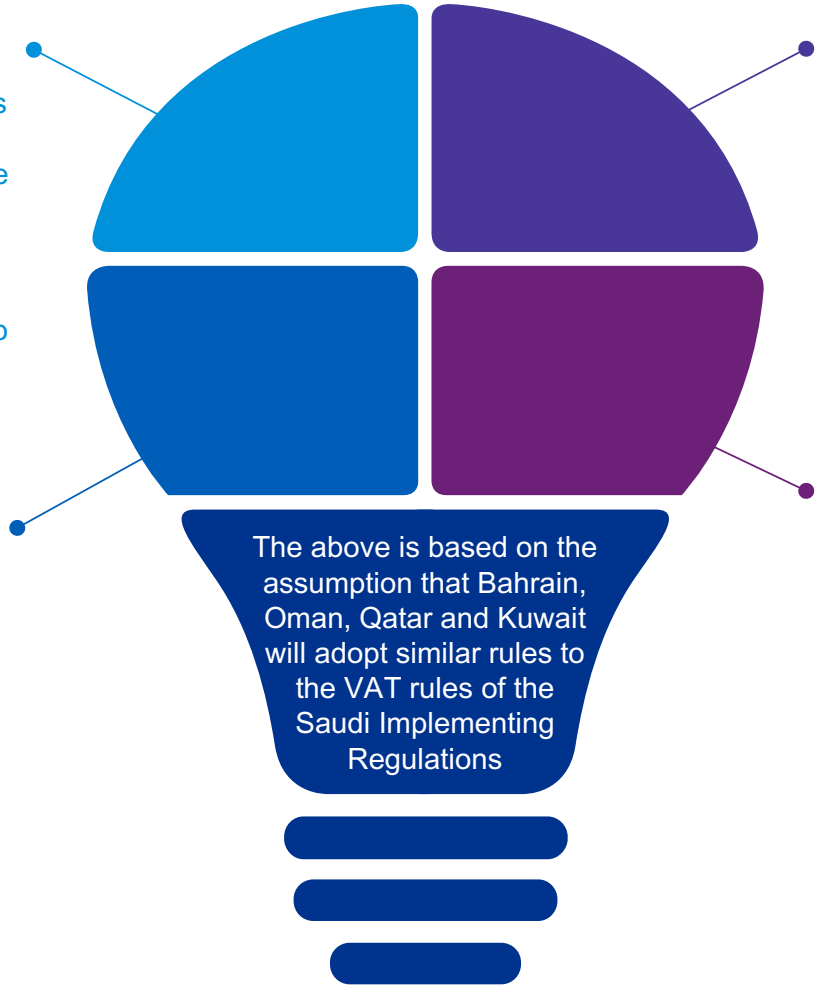
Sale of an aircraft prior to the introduction of VAT

— If the supply of the aircraft takes place before the introduction of VAT, no VAT should apply if the date of supply is mentioned on the invoice.

— If consideration is paid for a supply of a good/service prior to the introduction of VAT, but the delivery/supply will occur subsequent to the introduction of VAT, then the supply will be subject to VAT.

Sale of an aircraft after the introduction of VAT

— The supply of aircraft which meets the criteria for a qualifying means of transport used principally for the international transportation of passengers and goods should be zero-rated.



Lease rentals paid prior to the introduction of VAT

— Lease rentals paid in respect of an aircraft lease service supplied prior to the introduction of VAT should not be subject to VAT provided that the date of supply is mentioned on the invoice.

Lease rentals paid after the introduction of VAT

— Lease rental payments should be zero rated where the aircraft in question meets the criteria for a qualifying means of transport used principally for the international transportation of passenger and goods.

Bahrain

Indirect taxes

— Bahrain currently does not impose any VAT, GST or other sales tax.

— VAT at the rate of 5% is expected to be introduced from 2019 onwards.

MLI

— Not a signatory to the MLI.

Oman

VAT

— Oman currently does not impose any VAT, GST or other sales tax.

— VAT at the rate of 5% is expected to be introduced from 2019 onwards.

Withholding tax on lease rentals

— Oman imposes WHT at the rate of 10% on outbound lease rental payments.

— The liability to deduct WHT is with the payer (i.e. the Omani resident lessee).

— We understand that airlines in Oman can apply for a domestic exemption from this WHT, which is granted on an aircraft by aircraft basis. The airline should be responsible for making the application.

— There is currently no DTA in place between Ireland and Oman.

MLI

— Not a signatory but has committed to signing the MLI.

Qatar

VAT

— Qatar currently does not impose any VAT, GST or other sales tax.

— VAT at the rate of 5% is expected to be introduced from 2019 onwards.

Withholding tax on lease rentals

— WHT at a rate of 5% on aircraft lease rentals.

— The Ireland / Qatar DTA should provide relief from any WHT.

— Lessee is required to WHT and the lessor is required to request a refund of the amount paid from the Qatari tax authorities when treaty relief is being relied upon.

— In practice, we understand that Qatari Airways benefits from a domestic tax exemption from IT and WHT where the airline accepts the burden of any WHT or IT obligations under the lease contract.

MLI

— Not a signatory but has committed to signing the MLI.

VAT

— Kuwait currently does not impose any VAT, GST or other sales tax.

— VAT at the rate of 5% is expected to be introduced in 2021.

Withholding tax on lease rentals

— By way of background:

  — Kuwait does not impose WHT on lease payments to a non-resident lessor.
  — Income from rental or leasing of assets located / based in Kuwait is taxable in Kuwait at a rate of 15% of taxable profits (on a net basis).
  — Where an entity is earning lease income from Kuwait, the lessor is required to comply with the filing requirements (i.e. required to file a CT return).
  — In principal, the lease of an aircraft / engine should be exempt from Kuwait tax under the Ireland / Kuwait DTA.
  — In practice, Irish lessor register for Kuwait CT and claim to be fully exempt from Kuwait CT under the Ireland / Kuwait DTA as an initial filing position (i.e. file a nil CT return).

— KTA very recently agreed with an Irish lessor that it should be entitled to the benefit of the Ireland / Kuwait DTA and accepted a nil CT filing position. This is the first ever treaty claim granted by the KTA

MLI

— Signed up for the MLI on 7 June 2017.

— No formal guidance on ratification.

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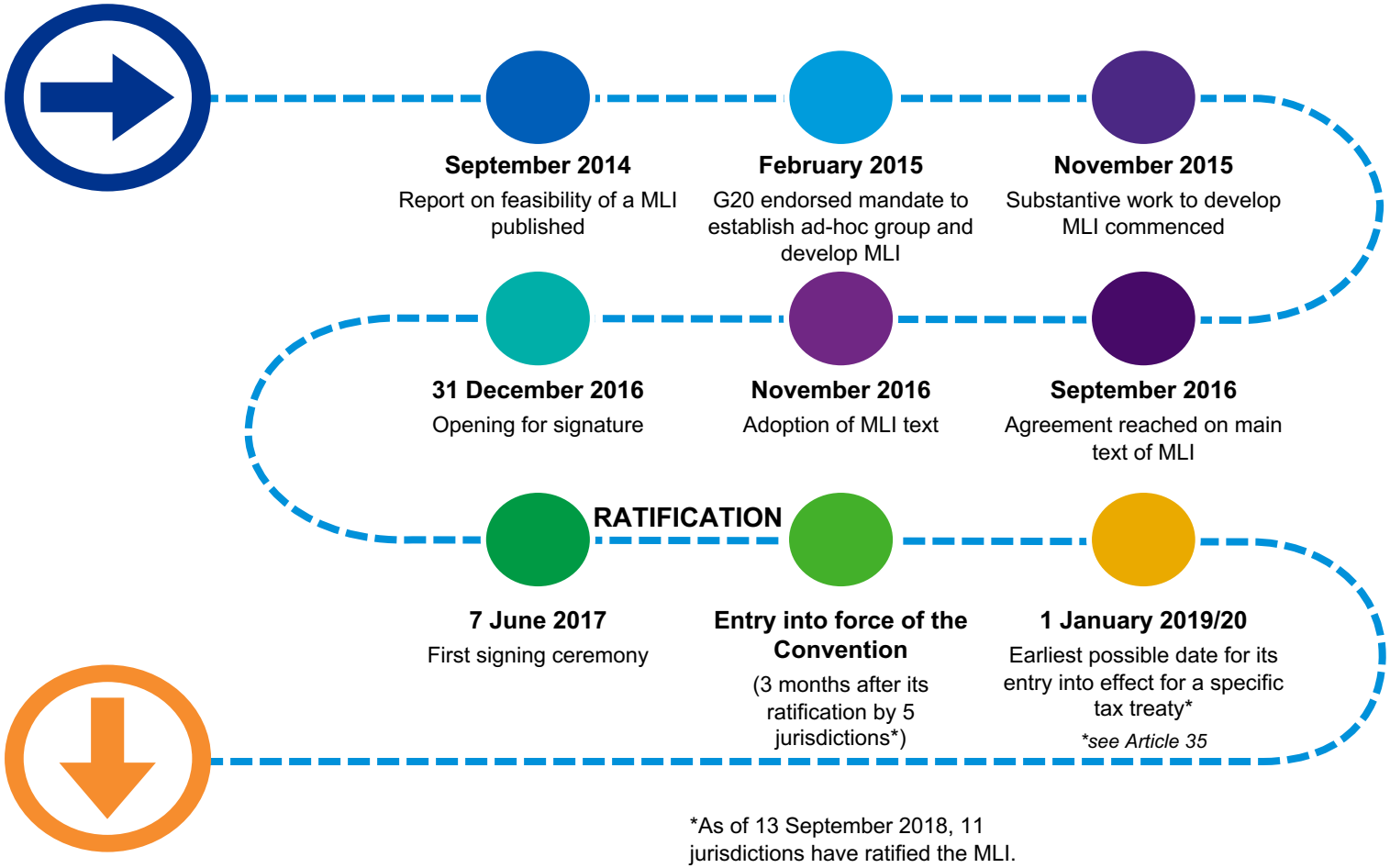
The MLI and its impact for lessors

What is the MLI?

- As part of BEPS project, the OECD has proposed significant changes to the global tax rules, including to double tax agreements.
- The Multilateral instrument ("MLI") is a legal instrument under which countries, including Ireland, set out a range of changes which they are willing to adopt into their double tax treaties.
- These changes will be adopted where equivalent choices are made by the tax treaty counterparty and enacted into the law of both countries. Some changes are "minimum standard" (i.e. required), others are "best practice" (i.e. some level of optionality).
- On 7 June 2017, representatives from over 70 jurisdictions, including Ireland, participated in an OECD ceremony for the signing of the MLI (US did not sign up but already has many similar provisions). As of 13 September 2018, 83 jurisdictions have signed the MLI.
- Once implemented by all signatories, expected to impact over 1,100 international tax treaties currently in force globally. The OECD expects the number of modified tax treaties to continually increase as additional jurisdictions sign the MLI.

Timeline for adoption of the MLI



*As of 13 September 2018, 11 jurisdictions have ratified the MLI.

RATIFICATION / ADOPTION

Impact of MLI for Irish lessors

In terms of the aircraft leasing business, choices made by countries on the following aspects of the MLI are very relevant:

1. Dependent Agent permanent establishment ("PE") threshold;
2. Changes to treaty preamble; and
3. Introduction of Principle Purpose Test ("PPT") and/or Simplified Limitation on Benefits provision ("LOB").

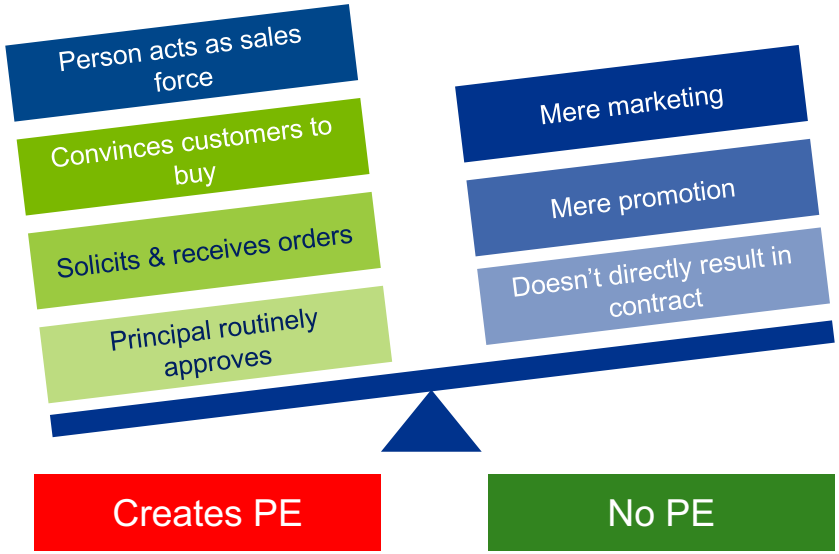
Other changes may have an impact on aircraft lessors depending on the exact group circumstances.

PE changes - impact for aviation sector

- Lowering threshold for non-independent agents to create a PE from "habitually concludes contracts" to:

  *"..habitually concludes contracts, or habitually plays the **principal role** leading to the **conclusion of contracts** that are routinely concluded **without material** modification.."*

- Potentially significant for leasing groups which have people travelling internationally and involved in buying, selling and leasing aircraft. The changes are targeted at on the ground teams that negotiate the terms of contracts but do not formally conclude contracts.
- Key issue for leasing sector given the fact that senior executives/ marketing personnel regularly visit local customers to discuss contract terms.



- Important to evidence 'head office' decision making on – needs to do more than merely 'rubber stamp' the final contract. Financial & compliance impact as need to file tax returns in PE jurisdictions.
- Not a minimum standard – will not get adopted into treaties unless both parties agree – less than half of countries who signed up to MLI have elected to impose in the first instance

PPT / LOB and preamble changes

- New approach to address tax treaty shopping arrangements, measures include:
  - Clear statement not to avoid tax (including treaty shopping);
  - Then either a Limitation on benefits clause ("LOB") which focuses on ownership, base erosion and activity (criticised for its complexity) or a Principal purposes test ("PPT") which focuses on whether one of the main purposes is accessing tax treaty (criticised for its uncertainty).
- Most parties to MLI have chosen PPT – very subjective, open to different interpretation by countries
- Emphasis on commercial purpose – focus on structure and substance. For lessors who have robust commercial substance and direct leases, should be able to continue to rely on the benefits of the relevant Irish treaties
- For intermediary lease structures high degree of uncertainty as to whether these will continue to operate as currently in a post-MLI world. In time, greater substance may be required in lease intermediary jurisdictions in terms of people, ability to generate profit and number of aircraft under lease in order to sustain certainty of access to treaty benefits. The position is unlikely to be the same in each country.

BEPS / MLI influenced developments with airlines

- Generally more focus on substance and beneficial ownership:
  - Russian airlines in relation to the application of Russia's beneficial ownership rules;
  - Korean airlines in relation to the application of Korea's beneficial ownership rules;
  - Indian airlines in relation to provisions that give greater comfort to the airline that the lease should not fall foul of India's General Anti-Avoidance Rule ("GAAR"), including: (i) requests from that Lessors have "commercial substance" in their home jurisdictions; (ii) requests that Lessors are "actively" engaged in aircraft leasing;
  - Indonesia recently released more onerous treaty claim forms (though we are not aware of any change in the approach by Indonesian airlines as of yet)
  - Ukrainian airlines have begun to requesting confirmations of beneficial ownership.
  - Beneficial ownership remains a sensitive point to French and Italian lessees.
  - Australian tax office have carried out reviews of LILO structures from time-to-time.

Conclusion and next steps

1. Increased focus on substance likely to continue and grow to further jurisdictions
2. Lessors should consider their substance position - expectation that any lessor that currently has an “active trade or business” for the purposes of the US treaty should satisfy a PPT test.
3. Identify leasing intermediaries structures and whether the number of intermediary jurisdictions could be reduced.
4. In due course, may be merit discussing MLI impact with airlines – often best placed to open discussions with local tax authorities (either on domestic rules or seeking new treaties)
5. Review leases to see if the lease provisions offer adequate contractual protection for changes in law under the MLI.
6. As attitude to PPT develops, necessary to review impact on common aircraft ownership structures. The use of shareholder debt may also be impacted.

Q&A

Thought Leadership

Our opinion is widely respected. KPMG's Accounting Research Online is a reference library of authoritative accounting and financial reporting literature and interpretive KPMG guidance. Subscriptions are available for International, United States and/or United Kingdom content for a total fee of U.S. $2,550 per annum. The Web-based library has an easy-to-use browsing system for finding documents and powerful search capability. KPMG's Accounting Research Online is updated every business day, allowing subscribers to access regulatory pronouncements and KPMG guidance as the literature is released.

We also share our knowledge and experience with our clients through a broad range of accounting, regulatory and industry focused publications, seminars and workshops, some of which include:

Aviation Finance: Financial Modelling - The Aviation industry is a data-intensive sector that relies on complex models to determine financing requirements, asset trading strategies, maintenance reserves and other management and accounting reporting requirements.

Our dedicated Aviation Financial Modelling team in Ireland understand the challenges you face. Whether you are looking to review or benchmark your existing models, require independent transaction modelling assistance or want assistance to build on your existing capabilities, we can help.

IFRS Newsletter: Leases - In a major shake-up of lease accounting, the IASB and FASB have published revised proposals to bring most leases on-balance sheet for lessees. Despite the significant divergence on key aspects of their lease proposals earlier this year, the Boards appear determined to finalize this long-running project – even if it results in non-converged standards.

Aircraft Financing, Fourth Edition: Essential reading for anyone involved in the aviation industry, this update to 1998's third edition examines an extensive range of topics, including the commercial, accounting and legal trends in the industry. Chapters by KPMG Ireland Partners offer observations and guidance on industry developments from an accounting and tax perspective.

Airfinance Journal: As the leading financial intelligence resource in the aviation industry, Airfinance Journal regularly requests contributions from KPMG on accounting and taxation issues affecting the industry. KPMG Ireland partners regularly discuss and are quoted on the proposed leasing standard's possible impact on the aviation and leasing industry.

Leasing Taxation: Leasing Taxation provides insight into the tax treatment of asset financing transactions in a range of different jurisdictions. In addition to outlining the direct and indirect tax treatment of leasing in each of the countries covered, legal and accounting issues are also discussed.

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Thank you

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