



# Tax Update:

Implications on the finance and leasing sector of new taxation regulations coming into force

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# Agenda

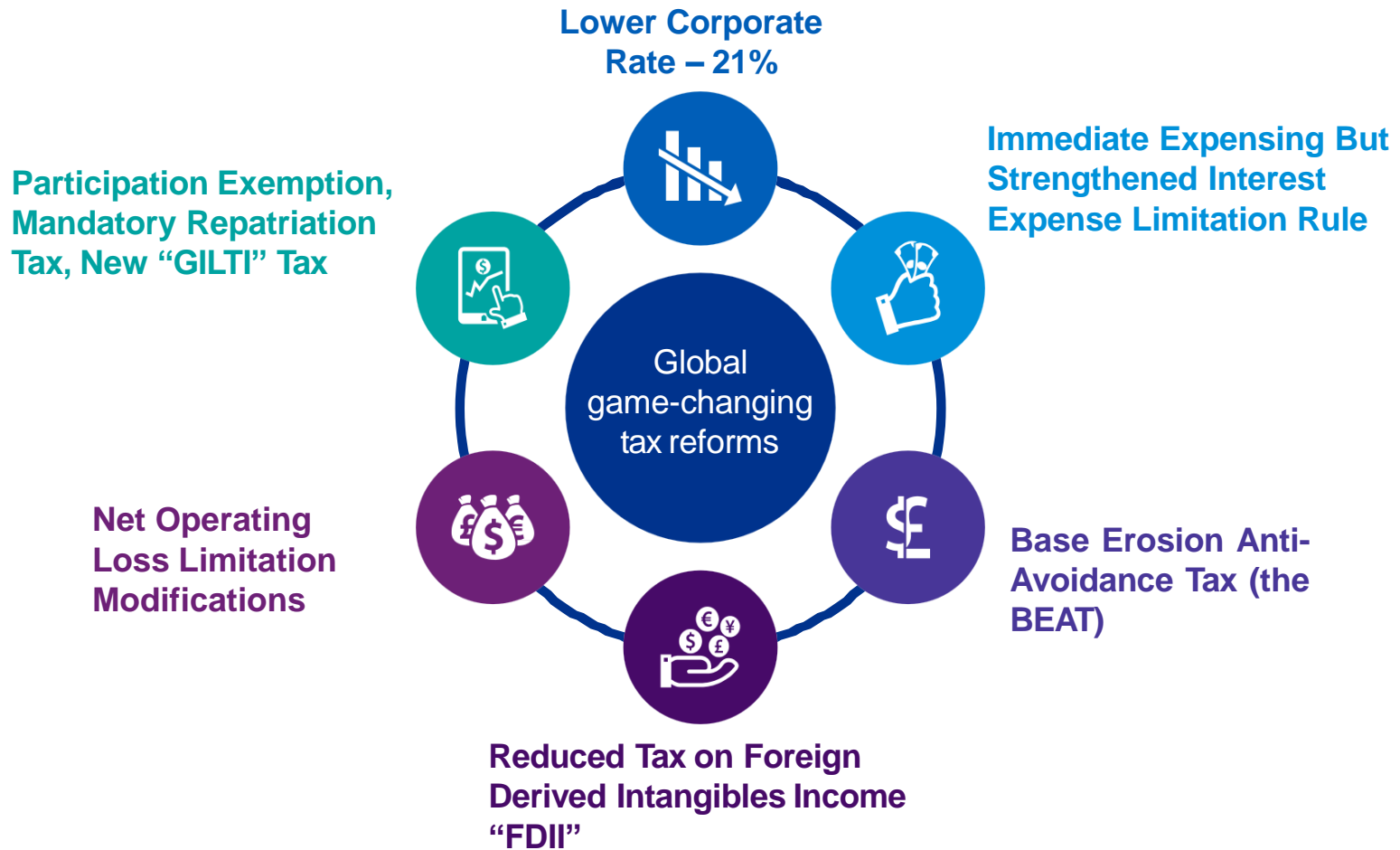
- US Tax Reform: Impact on Lessors
- BEPS Update: Impact of Multi-Lateral Instrument on Lessors
- Other Hot Topics



# US Tax Reform: Impact on Lessors



# US TAX Reform - Impact on Lessors



# US TAX Reform - Impact on Aviation & Leasing

Key Provisions – General Corporate Tax Measures		Aviation & Leasing Impact
<p><b>Lower corporate tax rate &amp; AMT repeal</b></p>	<ul style="list-style-type: none"> <li>• 21% rate (reduced from current 35% rate). Repeal corporate AMT</li> <li>• State taxes increase overall effective tax rate. Remains to be seen if states will follow US tax reform.</li> <li>• No change to the ability of corporates to claim a tax deduction for state taxes.</li> </ul>	<ul style="list-style-type: none"> <li>• Write down of deferred tax assets/liabilities. Consider if the rate should be lower than 21% due to FDII/BEAT.</li> </ul>
<p><b>Immediate expensing</b></p>	<ul style="list-style-type: none"> <li>• 100% expensing for certain qualified capital expenditures (both new and certain acquired 'used' property) for five years.</li> <li>• Extended phase-out between 2023 and 2027.</li> <li>• Not applicable to goodwill or intangibles (unlikely to include the portion of an aircraft's acquisition price booked as a lease/maintenance intangible for accounting purposes).</li> <li>• Taxpayer can elect to apply 50% allowance in lieu of 100% allowance for first year ending after 27 September 2017.</li> </ul>	<ul style="list-style-type: none"> <li>• Generates immediate tax shelter but net operating loss (NOL) restriction applies to unutilised depreciation.</li> <li>• Aircraft must be used predominately in the US. Old rules (<i>i.e.</i> 12 years straight line depreciation still apply for non-US aircraft).</li> <li>• Certain related party restrictions</li> <li>• Sale &amp; leaseback transactions (FDII unlikely to apply to depreciation claw back).</li> <li>• Could incentivise US airlines which pay cash tax to buy rather than lease?</li> <li>• Timing of deliveries important.</li> </ul>

# US TAX Reform - Impact on Aviation & Leasing

Key Provisions – General Corporate Tax Measures		Aviation & Leasing Impact
<p><b>Strengthened interest expense limitation</b></p>	<ul style="list-style-type: none"> <li>• Phased-in U.S. net business interest expense limitation -- based on 30% EBITDA until 2022, and thereafter applied on 30% EBIT (tax rather than accounting measure of EBITDA &amp; EBIT used).</li> <li>• Indefinite carryforward of disallowed expense – deferred tax and provisioning treatment of restriction.</li> <li>• No grandfathering.</li> <li>• Applies to unrelated and related party debt.</li> </ul>	<ul style="list-style-type: none"> <li>• Expected Operating (true) lease will be excluded (subject to IRS regulations).</li> <li>• Could it make leasing more attractive to airlines than purchasing (if purchase is debt financed)?</li> <li>• Finance leases likely included if akin to a loan for US tax purposes.</li> <li>• Need to limit intra-group debt funding into the US to the amount that is actually likely to be tax deductible?</li> <li>• Tax Provision / DTA impact.</li> <li>• From 2022, EBIT measure used. Aircraft Lessors may have a low or negative EBIT (limited at zero for the purposes of the test) due to tax depreciation, thereby restricting interest deductions entirely.</li> <li>• Taxable gains / depreciation recapture on sale of aircraft may increase “earnings” for the purposes of the test.</li> </ul>

# US TAX Reform - Impact on Aviation & Leasing

Key Provisions – General Corporate Tax Measures		Aviation & Leasing Impact
<b>Hybrid mismatch rule</b>	<ul style="list-style-type: none"> <li>• BEPS style measure – further detail awaited.</li> <li>• Broadly disallows U.S. tax deductions for interest and royalties paid or accrued to a related party in connection with hybrid transactions and/or hybrid entities.</li> <li>• Exception for amounts otherwise includible as U.S. taxable income (e.g., Subpart F income).</li> </ul>	<ul style="list-style-type: none"> <li>• Potentially some impact on financing structures and dual resident companies?</li> </ul>
<b>NOL limitation modifications</b>	<ul style="list-style-type: none"> <li>• Annual use of future NOL carryforwards generally limited to 80% of corporate taxable income. This restriction should not apply in the year that the loss is generated.</li> <li>• Use of ‘pre-reform’ NOL carryforwards (<i>i.e.</i>, losses arising in tax years beginning before 1/1/2018) still applied up to 100% of corporate taxable income.</li> <li>• In future periods, pre 1 January 2018 NOLs used in priority.</li> <li>• Indefinite carry forward of post-2018 tax losses but generally no carryback allowed for tax post 2017 tax years.</li> <li>• NOLs arising in tax years ending before 1/1/2018 remain subject to 20 year carryforward / 2 year carryback rules.</li> <li>• Interaction with BEAT / FDII.</li> </ul>	<ul style="list-style-type: none"> <li>• Effective 4% cash tax in period that NOLs are used.</li> <li>• Impact on “Blockers” in fund structures or US ABS vehicles.</li> <li>• For aircraft lessors, the NOL restriction may offset much of the benefit of immediate expensing.</li> </ul>

# US TAX Reform - Impact on Aviation & Leasing

Key Provisions – Int’l Tax Measures Affecting Inbounds	Aviation & Leasing Impact
<p><b>Reduced rate for foreign-derived intellectual property income (FDII) of US corporations</b></p>	<ul style="list-style-type: none"> <li>• Tax-deduction for certain foreign-derived IP income of U.S. corporations.</li> <li>• 37.5% deduction (13.125% ETR) for U.S. entity’s ‘foreign-derived intangible income for tax years 2018-2024.</li> <li>• For taxable years beginning after 31/12/25, the deduction drops to 21.875% (16.406% ETR).</li> <li>• Applies to income from sales, rentals and licenses of property or provision of services to non-U.S. entities/persons for use outside the U.S.</li> <li>• Deemed intangible income eligible for deduction is the excess of certain gross income over deemed 10% return on average tax basis of certain tangible assets.</li> <li>• Certain related-party anti-abuse rules.</li> <li>• WTO challenge?</li> </ul>
<ul style="list-style-type: none"> <li>• Could apply to certain income generated by US lessors. Benefit potentially limited by 10% return threshold.</li> <li>• Does not apply to aircraft leased to US airlines and aircraft used in the US.</li> <li>• Interaction of tax depreciation with calculation of 10% threshold (<i>i.e.</i> tax depreciation reduces average tax basis of assets which is used for 10% threshold).</li> <li>• Potential impact on deferred tax assets/liabilities valuation / valuation allowances.</li> </ul>	



# US TAX Reform - Impact on Aviation & Leasing

Key Provisions – Int’l Tax Measures Affecting Inbounds	Aviation & Leasing Impact
<p><b>Base Erosion Anti-Avoidance Tax (the BEAT)</b></p> <ul style="list-style-type: none"> <li>• Broadly, potential minimum tax imposed on U.S. companies having deductible ‘base erosion payments’ made to related foreign companies (25% related party test).</li> <li>• BEAT rate summary:               <ul style="list-style-type: none"> <li>➢ 5% - 2018.</li> <li>➢ 10% - 2019 to 2025 (<i>special 11% rate applies for affiliated groups that include banks and/or securities dealers</i>).</li> <li>➢ 12.5 % - after 2025 (13.5% for affiliated groups that include banks and/or securities dealers).</li> </ul> </li> <li>• Minimum tax liability equals excess of 5/10/12.5% (or applicable rate above) of the U.S. company’s ‘modified taxable income’ (“MTI”) over its regular U.S. tax liability reduced by certain allowable credits.</li> <li>• Broadly, MTI is taxable income plus certain ‘base erosion payments’ and NOLs allocable to such payments. Further guidance on NOLs expected.</li> <li>• Base erosion payments include (i) deductible payments and (ii) depreciable/amortizable amounts .</li> <li>• Generally exclude COGS payments but include allowable interest expense and certain low value service payments.</li> <li>• Only mark-up on services includible or entire cost of service – Await Regulations.</li> <li>• Only applies to large taxpayer groups:               <ul style="list-style-type: none"> <li>➢ Groups with annual average global U.S. gross receipts <math>\geq</math> \$500M over 3-years (50%+ group); and</li> <li>➢ base erosion % (base erosion deductions / total allowable deductions) <math>\geq</math> 3%</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Determine if clients breach USD500mm threshold – look at entire group.</li> <li>• IRS Regs may clarify if US ECI needs to be included even if treaty protected (e.g. aircraft leasing to US airline).</li> <li>• Potentially significant impact on US LILOs (effectively a minimum tax on head lease rentals).</li> <li>• Tax depreciation on related party purchases potentially caught (<i>i.e.</i> difficult to move aircraft back to the US). Grandfathering for acquisitions in periods commencing prior to 1 January 2018.</li> <li>• Potentially advantageous to acquire aircraft from third parties in the US if BEAT issue?</li> <li>• Treatment of aircraft sales for gross receipts test?</li> </ul>

# US TAX Reform – Impact on Aviation & Leasing

Key Provisions – Int’l Tax Measures Affecting CFC Sandwich Structures	Aviation & Leasing Impact	
<p><b>Mandatory repatriation</b></p>	<ul style="list-style-type: none"> <li>• Deferred foreign corp earnings subject to one-time tax – applies to <math>\geq 10\%</math> U.S. shareholders.</li> <li>• 15.5% rate on cash and liquid assets / 8% rate on non-cash and illiquid assets.</li> <li>• Election to pay tax liability in instalments over 8 years.</li> <li>• Onerous multiple testing dates to determine earnings and aggregate cash position. Other complex rules apply.</li> <li>• Potential impact of FY 2017 accruals.</li> </ul>	<ul style="list-style-type: none"> <li>• Potential impact for some US headquartered groups.</li> <li>• Likely to be very specific to their facts as they tend to have non-aviation activities outside the US.</li> </ul>
<p><b>Foreign source dividend exemption system</b></p>	<ul style="list-style-type: none"> <li>• Creates 100% exemption for dividends received by U.S. corporations from 10% owned foreign corporations attributable to non Sub-F and non GILTI returns.</li> <li>• Also applies to certain share returns.</li> </ul>	<ul style="list-style-type: none"> <li>• Sufficient incentive for lessors to keep or move assets “offshore” (e.g. In Ireland)?</li> </ul>

# US TAX Reform - Impact on Aviation & Leasing

Key Provisions – Int’l Tax Measures Affecting CFC Sandwich Structures	Aviation & Leasing Impact	
<p><b>Super Subpart F regime</b></p>	<ul style="list-style-type: none"> <li>• Subpart F regime mostly unchanged, but expansion of Controlled Foreign Company (CFC) stock attribution rules and U.S. Shareholder definition (<i>i.e.</i> the 10% vote and value test).</li> <li>• Potentially significant increase in CFCs for inbound companies with “sandwich” structures – creates CFCs by attributing shares held by related foreign companies to U.S. shareholder.</li> </ul>	<ul style="list-style-type: none"> <li>• Likely specific to client facts/circumstances.</li> <li>• Potential impact on JVs.</li> </ul>
<p><b>Global CFC low-taxed excess returns tax</b></p>	<ul style="list-style-type: none"> <li>• New category of Subpart F income inclusion for U.S. Shareholders.</li> <li>• Very broadly, GILTI is 50% (37.5% after 2025) of the excess of the Shareholder’s share of all CFC’s non-Subpart F / non ECI income over a 10% return on certain tangible depreciable property (qualifying business asset investment - QBAI).               <ul style="list-style-type: none"> <li>➤ 10.5% ETR ratcheting up to 13.125% ETR for tax years beginning after 31/12/25.</li> </ul> </li> </ul> <p>Allowable foreign tax credits (FTCs):</p> <ul style="list-style-type: none"> <li>➤ Capped at 80% of foreign taxes paid</li> <li>➤ New separate FTC basket, and</li> <li>➤ No carryforwards or backwards</li> </ul>	<ul style="list-style-type: none"> <li>• Potentially complicated by non-aviation activities conducted by US headquartered groups.</li> <li>• Tax depreciation on aircraft potentially reduces basis on which 10% (GILTI exempt) threshold applies.</li> <li>• Impact on lessors mainly focused on servicing / asset management (<i>i.e.</i> better to locate in the US) out side the US.</li> <li>• Treatment of part out companies /entities will low levels of fixed assets.</li> </ul>



# BEPS Update: Multi-Lateral Instrument

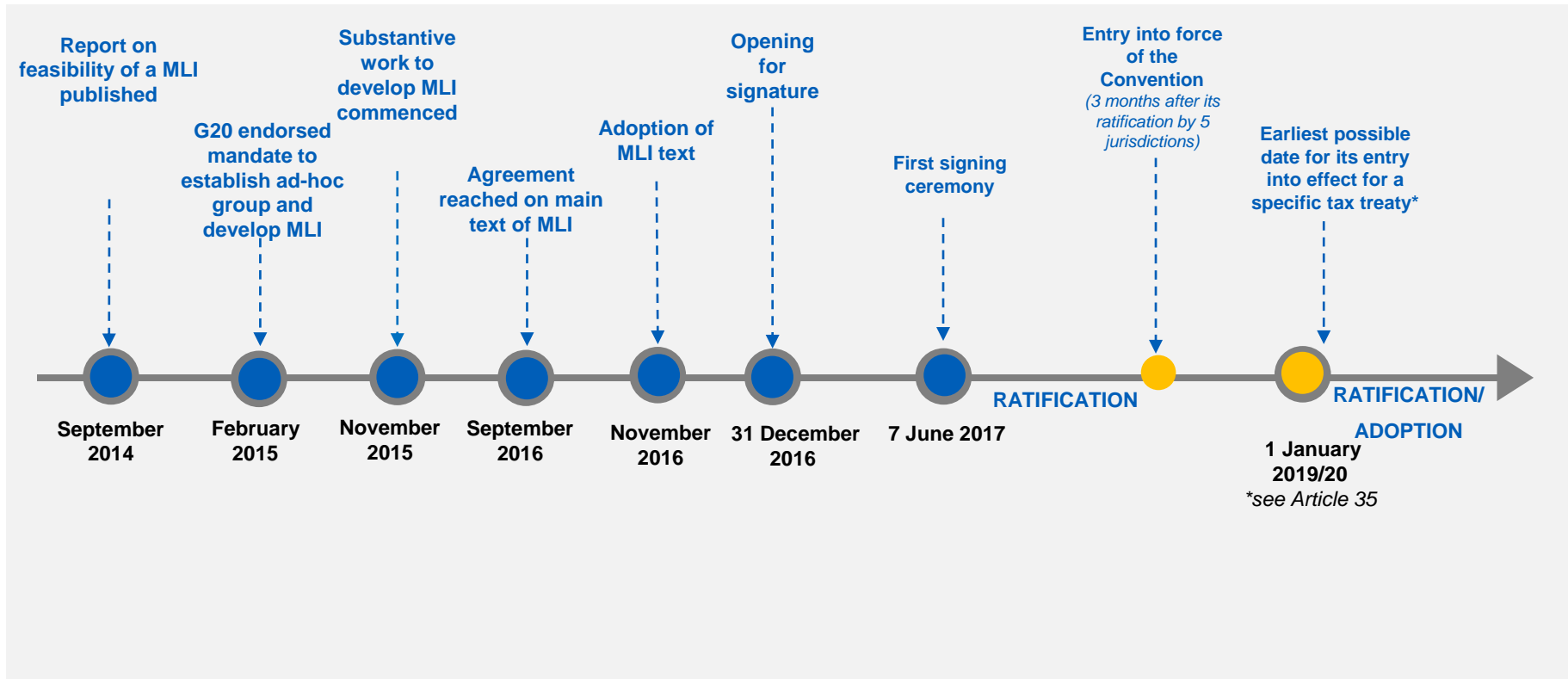


# What is the MLI?

- 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 & Hong Kong, participated in an OECD ceremony for the signing of the MLI (US did not sign up but already has many similar provisions).
- 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



# 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.

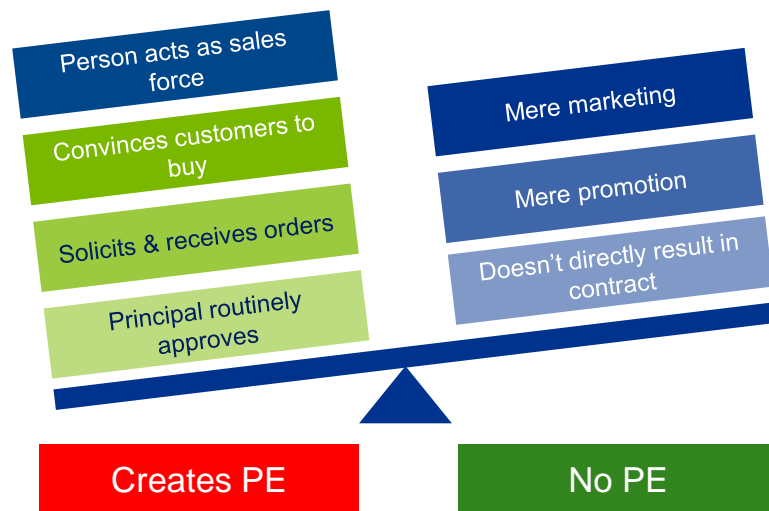


# PE changes - impact for aviation sector

- 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





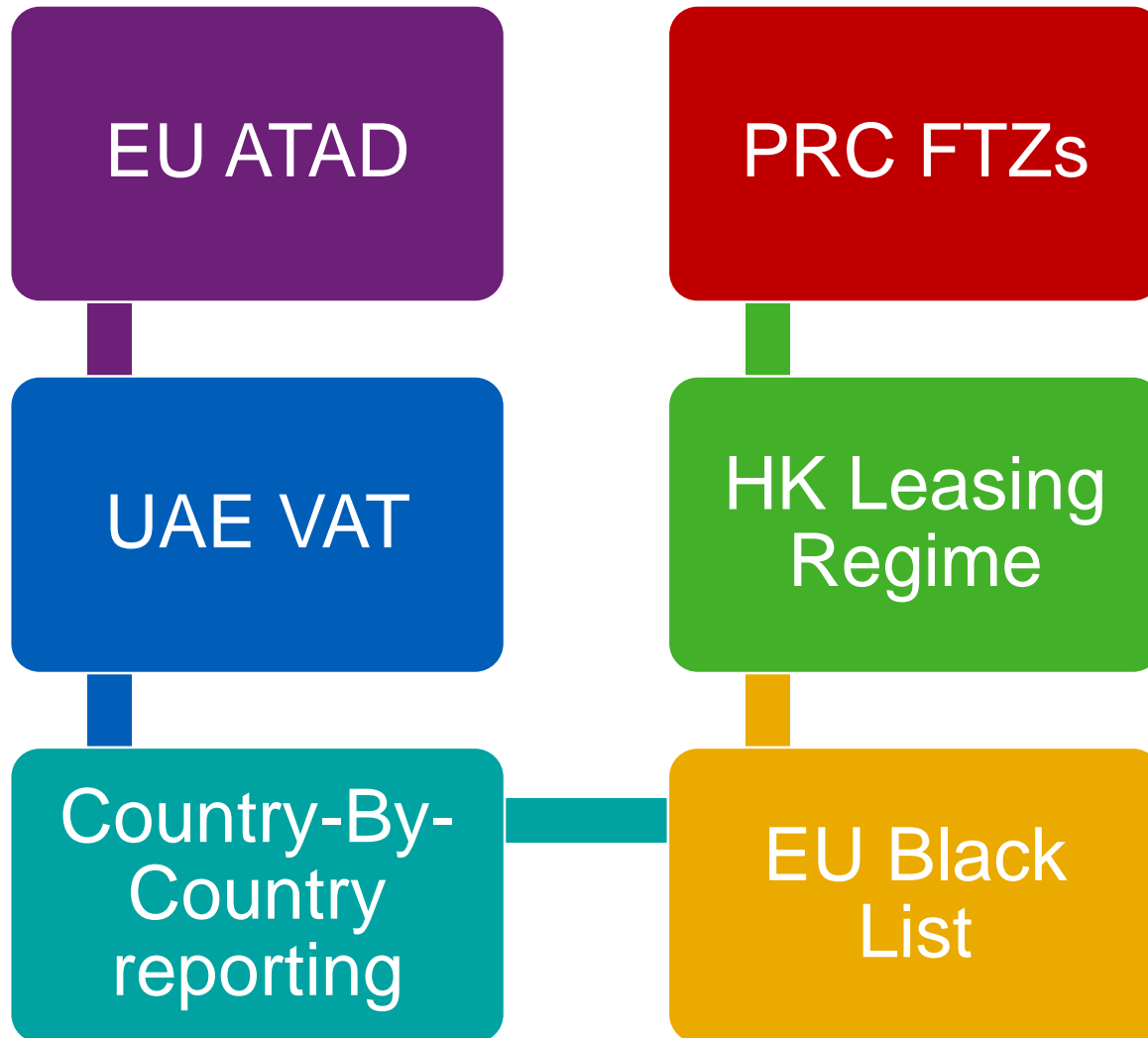
# PPT/LOB and preamble changes

- New approach to address tax treaty shopping arrangements, measures include:
  - Clear statement not to avoid tax (including treaty shopping);
  - Then either an **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.
  - 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.

# Other Hot Topics





# Thank you



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