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two – Public Consultation

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Comments on the Pillar Two of the Global Anti-Base Erosion Proposals

As a representative of the global aviation industry, Aviation Working Group (“AWG”)¹ welcomes this opportunity to comment on certain aspects of the OECD public consultation in relation to Pillar Two of the Global Anti-Base Erosion (“GloBE”) Proposals released on 8 November 2019 (the “Consultation Document”).

In particular, we have noted the following aspects of the consultation are particularly relevant to the aviation financing industry in the context of the introduction of the new Global Aircraft Trading System (“GATS”):

- 1 The use of financial accounts to determine income,
- 2 Temporary differences, and
- 3 Allocating income of a tax transparent entity.

Our comments on these aspects of the Consultation Document are presented below.

1 The use of financial accounts to determine income

The aviation financing and leasing industry includes a significant number of very large multinational groups with subsidiaries in multiple territories.

Effective tax rates are computed by reference to income, expenses and taxes reported in financial accounts. Financial accounts of aviation finance and leasing companies are in many cases prepared under International Financial Reporting Standards (“IFRS”) or Generally Accepted Accounting Principles (“GAAP”), particularly US GAAP.

The computation could be determined based on the accounting standard of the parent although where a subsidiary prepares audited financial statements under IFRS or other commonly used GAAP, it should have the option of using these accounts as the basis for

¹ AWG is a non-for-profit organisation comprised of major aviation manufacturers, leasing companies and financial institutions that contribute to the development of policies, laws, and regulations that facilitate advanced international aviation financing and leasing. A list of the AWG Members is set out in Appendix I.

the calculation of its effective tax rate if it so wishes. Both of these options should reduce the level of compliance and costs of administration.

2 Temporary differences

Aircraft lessors incur significant capital outlays on the acquisition of aircraft. Aircraft assets often give rise to large temporary differences by virtue of the carrying amount of an aircraft asset for accounting purposes and tax purposes due to the different rates of depreciation for accounting and tax purposes. These differences can result in low effective cash tax rates in the early years and a very high effective cash tax rate in later years or in the period when the aircraft is sold.

We, therefore, believe using deferred tax accounting under IFRS or other commonly used GAAP financial accounting standards is the most appropriate approach to neutralise the effects of temporary differences on the effective tax rate in order to fairly report the effective tax rate that will apply to a company's profits. Taxpayers already calculate deferred tax as part of their financial reporting process on entity-by-entity basis. Any other approach for determining the amount of tax would significantly increase the level of compliance and costs of administration.

3 Allocating income of a tax transparent entity

Trusts are often used to hold aviation assets and the introduction of the Global Aircraft Trading System ("GATS") will further increase the use of trusts in the industry. GATS is a system designed to modernize aircraft equipment trading and financing. Under GATS, it is proposed that each aircraft will be owned in a common law bare trust established under the laws of the United States, Republic of Ireland or Singapore. GATS will also permit the use of a Delaware statutory trust which has a separate legal personality.

A GATS trust creates a fiduciary relationship in which one party, the owner trustee (or the trust itself in the case of a statutory trust), agrees to hold title to assets for the absolute benefit of another party, the beneficiary. The owner trustee is the bare legal owner of the assets, held on trust for the beneficiary. The beneficiary ultimately owns and controls the assets of the trust estate and has the financial and legal risks and rewards of ownership (i.e. all income and gains / expenses and losses / assets and liabilities, are directly allocated to beneficiary and reported in the financial statements of the beneficiary). The trustee bears no commercial risk and has no beneficial, equitable or other interests in the asset, other than bare legal ownership. The trustee may be removed by the beneficiary at any time. The beneficiary can borrow and give security over the asset held under the trust and can otherwise deal in and control the asset as owner. This can include leasing the aircraft to an airline.

Tax analysis in the GATS trust jurisdictions

Such common law trusts do not have a separate legal personality. In the US, Singapore and Ireland under whose laws the trusts are established, the trust is considered to be transparent for tax purposes. In simple terms, this means that the beneficiary under the trust is effectively treated as the owner of the asset held under the trust for tax purposes. The Delaware statutory trust will be structured as a pass-through entity for US Income tax purposes with an equivalent tax outcome.

The tax treatment of the GATS trust

One of the objectives of the GATS project is that there is global recognition of the GATS Trust as a fiscally transparent entity (or “a pass-through entity”) for tax purposes, i.e. where competent authorities look through the trust to the beneficiary and regard the trust beneficiary as the beneficial owner in taxing the beneficiary.

AWG believes that it is important that the GATS Trust is treated as a transparent entity and the assessment of the effective tax rate is made on the beneficiary in the context of GloBE. For example, if the GATS Trust was not considered a fiscally transparent entity by the entity making the payment, this could lead to a failure to meet an effective tax rate test with income being included in the GATS Trust owner’s jurisdiction resulting in double taxation (under an income inclusion rule) or lease rental payments being non-tax deductible or being subject to withholding tax under a subject to tax or undertaxed payment rule, even where the beneficiary is subject to tax on the income. Furthermore, the proposed rules in relation to the determination of a consistent tax base and the proposed blending approaches could also be compromised if the trust is not universally treated as a transparent entity and the income is not assessed on the beneficiary. Treating the trust as a transparent entity for these purposes is consistent with the reporting of the income, gains, expenses, losses, assets and liabilities in the financial accounts of the beneficiary. The blending could therefore be assessed at a beneficiary group level (worldwide level) with an option, if more favourable, to assess at a jurisdictional or entity level.

An example could be included in guidance to be issued that a trust that holds the trust estate and all trust income, gains, expenses and losses absolutely for the beneficiary and where the beneficiary reports all of the income, gains, expenses, losses, assets and liabilities of the trust in its financial statements, that such a trust should be considered a fiscally transparent entity with all Pillar II assessments made at the beneficiary and beneficiary group level.

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Appendix I

AWG Members

