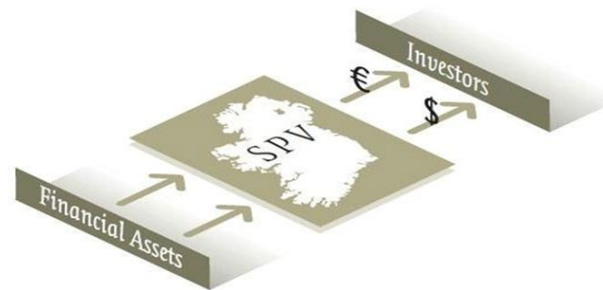




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Aircraft leasing and Ireland: Benefits and Issues



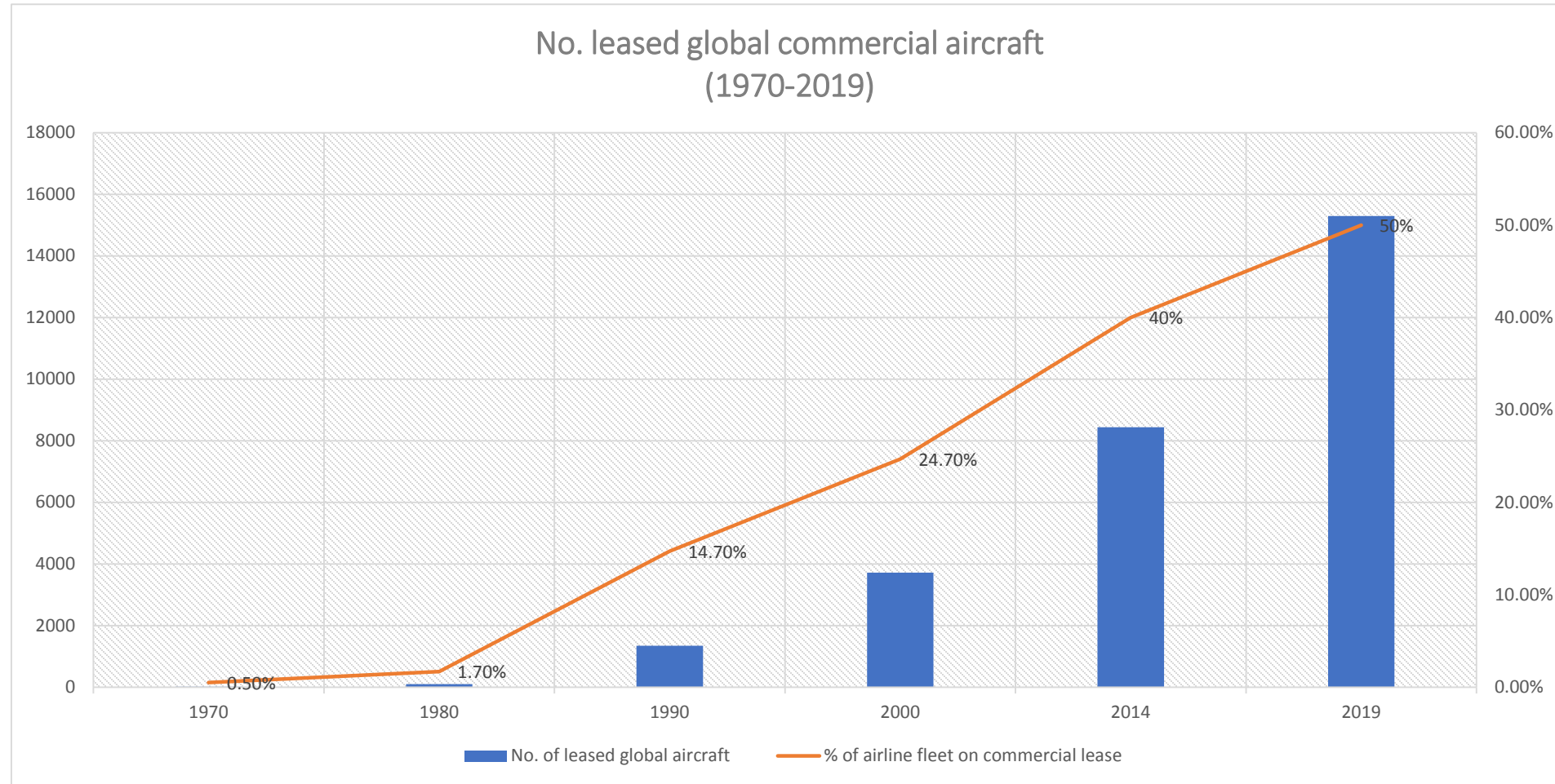
TASC Seminar 25th February 2020
Jim Stewart and Cillian Doyle

Introduction

The focus of our research is on:-

- Fiscal Incentives and economic development, in particular on 'Section 110' loans.
- Assets held by S. 110 firms are an important part of IFSC activities and shadow banking.
- The current paper uses publicly available data (CRO filings) and industry sources to examine:-
 - (1). The operations of the largest aircraft leasing firms operating in Ireland in terms of revenues, assets and employees;
 - (2). Operating characteristic and size of firms using 's. 110' finance.
- This topic is of significance given the role of Ireland in global aircraft leasing and climate change and the Green New Deal proposed by the Commission.

World Wide Growth in Aircraft Leasing



Source: Aviation News/Centre for Aviation (CAPA) database

The Size of the World Aircraft fleet

- The % of the commercial aircraft on lease has grown from 0.5% in 1970 to over 50% in 2019.
- KPMG (2019) state that the top 30 aircraft leasing firms had 12,263 aircraft leased in 2019 valued at \$336.8 billion.
- PWC state that “Over 60% of all leased aircraft worldwide are managed by Irish-based leasing companies”.
- If we assume that 50% of the world’s aircraft are leased/managed from Ireland, that would equate to around 7,650 aircraft registered here in 2019.
- Other sources state the global leasing fleet in Ireland came to 4,300 in 2018, of which 1100 were Chinese owned .
- There are other widely varying estimates of the size of the Global airfleet with implications for the size of the Irish Aircraft Leasing Industry.

Varying estimates of the size of the world aircraft fleet

Source/year	Total Airline Fleet	Stated % of population leased	Total Leased	% Leased from Ireland	Total Leased from IRL
Statista (2018)	25,380	50%	12,915	Not stated	?
Flight Global/Cafico International (2017)	18,960	Not stated	8,152	60%	4,300
Aeroreport (2018)	Not stated	Not stated	12,000	Not stated	Not stated
Deloitte/Fleet Tracker (2017)	26,000	38%	9,880	Not stated	Not stated
CAPA (Centre for Flight Aviation) 2018	30,600	50%	15,300	Not stated	Not stated
IBEC/Aircraft Leasing Ireland	Not stated	-50%	Not stated	+60%	Not stated
PWC (2018)	Not stated	Not stated	Not stated	65%	Not stated

Identifying Ireland's largest lessors

- KPMG's recent Aviation Industry Leaders Report (2019) listed the 30 largest lessors in the world.
- From this list 26 of the top 30 lessors were identified as having operations in Ireland.
- The organisational structures of these leasing firms are quite complex.
- Layered group and sub group ownership structures, involving large number of subsidiaries both inside Ireland and outside, are common.
- Generally a holding company acts as the consolidator of all the accounts for the subsidiaries (although not all), with a related management company providing services.
- The CRO data base was used to identify such holding/management companies and to extract operating data.

Estimates for largest Irish lessors (2011-18)

- According to PWC/Air Finance Journal in 2017 global aircraft leasing revenue were \$16.7 billion.
- Ireland's 26 biggest lessors with revenues of over \$7 billion in 2017, thus accounted for around 42% of entire global revenues.
- Gross assets reached \$93 billion in 2018, growing 3.5 times from \$26 billion in 2011.
- For the same period employment grew threefold, but remains low at around 1,549.
- Irish employees based mainly in Dublin and Limerick.
- The largest employer (2018) being GE Capital Aviation (GECAS) with 278 and the smallest being Castlelake with 5.

Estimates for largest Irish lessors 2011-18)

<i>Year/No. firms</i>	<i>Total Gross <u>Irl</u> assets (\$m)¹</i>	<i>Revenue <u>Irl</u> (\$m)¹</i>	<i>Pre-tax profits</i>	<i>Employees In Ireland</i>
2018 (26)	\$93,282	\$8,491	\$4,263	1,549
2017 (26)	\$86,520	\$7,052	\$2,544	1,323
2016 (26)	\$71,687	\$6,692	\$1,749	1,041
2015 (26)	\$60,037	\$6,141	\$858	953
2014 (24)	\$57,439	\$5,285	\$979	750
2013 (22)	\$39,301	\$3,909	\$724	581
2012 (22)	\$29,311	\$3,200	\$207	544
2011 (23)	\$26,059	\$1,478	\$210	506

CSO Data on Aircraft Leasing (Euro million).

- CSO shows data shows similar trends for the leasing sector in Ireland

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Cash and Bank Deposits	555	418	521	290	446	1,445	1,899	3,193	4,691	4,887
Debtors	2,265	1,810	1,810	1,404	3,242	3,209	3,847	17,013	18,943	19,399
Loans	1,100	4,399	4,360	6,733	7,073	8,816	8,765	8,560	5,563	11,352
Tangible Fixed Assets	27,385	28,625	31,475	35,621	38,726	43,980	47,073	77,480	*	*
Other	2,191	4,475	5,042	4,035	6,394	8,362	6,464	10,862	*	*
Total Assets	33,496	39,727	43,209	48,083	55,881	65,812	68,048	117,108	128,567	141,633

Ambiguities in data ?

- Varying industry estimates of the size of the global aircraft leasing market may indicate ambiguities in data.
- For example data from aircraft leasing firms includes subsidiaries of Irish registered firms with foreign leasing subsidiaries.
- So that firm level data reflects both leased aircraft registered in Ireland and leased aircraft registered outside Ireland but controlled from Ireland.
- A detailed study of 'section 110' firms report that they act as both lessors and lessees, which may result in some double counting.
- KPMG (2019, p. 44) state:-
- “The aviation industry has traditionally shrouded its deals in secrecy; airlines and operators rarely if ever publicise the purchase price of their aircraft, whether from manufacturers nor in the secondary market, or disclose the pricing of their financing agreements or lease rates”.
- Deloitte (2014, p. 3) state:- “that accurate statistics on the size of the aircraft leasing sector in Ireland are difficult to establish”.

Projected Growth is large

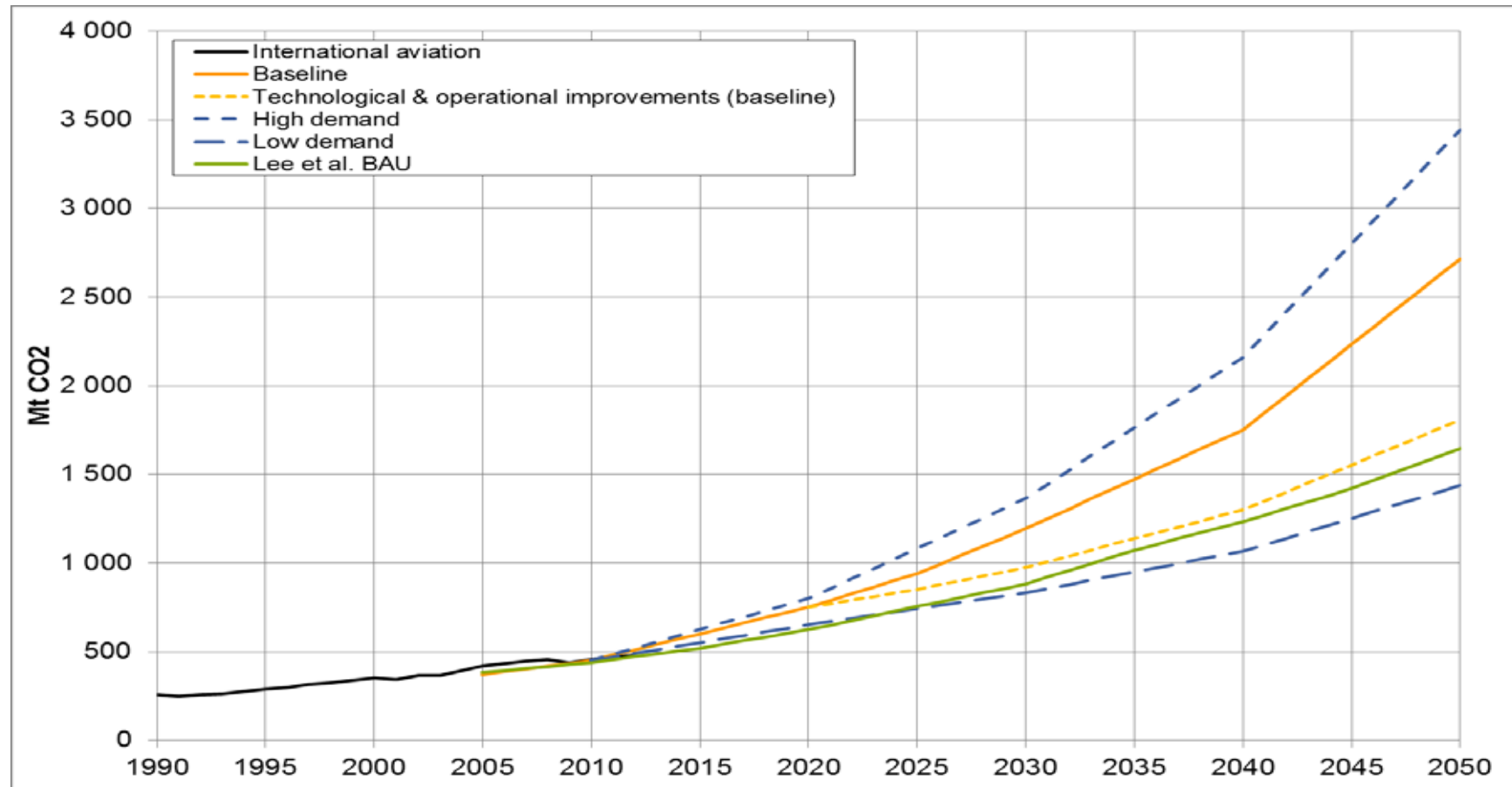
- The director of S&P global ratings has attributed future expected airline growth to:-
 - “the desire among millennials and Generation Z to travel and experience the world, while the older generation are also spending their retirement traveling” (KPMG, 2019, p. 9).
 - For Ireland PWC states (2019, p. 8):- “In the coming years to 2021, respondents expect continued growth with estimates of a 22% increase in the number of aircraft units held by Irish lessors.
 - Angela Fleming (Tax Director at BDO) states :-
 - “...the outlook for aircraft leasing in Ireland is positive with the country remaining the perfect location for lessors to continue to establish and develop their leasing platforms” (Irish Independent, Feb. 25, 2019).
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- **Why Ireland**
 - There are three main reasons given why Ireland is the main location for leasing aircraft:-
 - Tax incentives;
 - A very favorable legal system;
 - Relatively light touch regulation

The Role of Tax Incentives

- PWC cite four main reasons for the growth of aircraft leasing in Ireland (2019, p. 19)
- Two relate to the tax regime, a third is regulatory structure.
- Deloitte state:- “The Irish rules regarding a lessor’s entitlement to capital allowances can be quite flexible” and that “the legal structure and documentation of a lease transaction can be influential”.
- This raises the issue of what is termed ‘double dip depreciation, that is both the lessor and lessee could both claim capital allowances.
- Deloitte comment (p.14) that a double dip is “often possible”.
- In the case of assets leased in Ireland the lessor may be tax resident in another country, for example Malta.
- There are also several reference to Ireland’s legal system.
- Dillon Eustace state :-
- “The legal and regulatory framework which exists in Ireland affords the requisite degree of stability, sophistication and user friendliness which, allows aviation industry participants to establish, operate and raise capital with relative ease.”
- Deloitte (2014, p. 3) cite as a major advantage “There is no specific regulation of big ticket aircraft leasing activities and lessors in Ireland” and “Any entity or individual can operate an aircraft leasing trade in Ireland”.

Climate Change and projected Aircraft Emissions

- Michael O'Leary (Ryanair) has been quoted as stating that climate change concerns are "complete and utter rubbish". Irish Independent 8/4 2017.
- These sentiments cannot be found in industry projections.
- But what is striking is the absence of any discussion of climate change.



- The European commission state (https://ec.europa.eu/clima/policies/transport/aviation_en):-
- “Direct emissions from aviation account for about **3% of the EU’s total greenhouse gas emissions and more than 2% of global emissions.**
- By **2020**, global international aviation emissions are projected to be **around 70% higher** than in 2005 and the International Civil Aviation Organization (ICAO) forecasts that **by 2050 they could grow by a further 300-700%”**.
- The Commission have identified tax exemptions in certain sectors as factors inhibiting incentives to reduce emissions.
- The Commission state (EU 2019a pp. 4-5):-
- These tax exemptions or reductions constitute a burden for other sectors and/or private households that have to make up the revenue shortfalls triggered by them.
- Furthermore, they may distort competition between industrial sectors and may promote inefficient and polluting modes of transport” .

What are the Tax Exemptions ?

- Tax exemptions that have been widely referred to are:-
- Airline tickets in Europe are exempt from VAT;
- There is no excise duty or VAT levied on fuels;
- Purchases of aircraft for international routes are non-taxable.
- However what has not received much attention is that at least half of the world's leased aircraft receive very favourable tax concession because holding companies are based in Ireland.
- These tax concessions provide very favourable incentives for purchasing aircraft via depreciation allowances and subsidies for financing aircraft purchase via s. 110 loans

The Benefits of S. 110

- S. 110 refers to 's.110 of the taxes consolidated Act 1997.
- This provision introduced beneficial tax arrangements for firms engaged in financial activities, mostly acting as financial intermediaries.
- The scope of this provision was extended to aircraft leasing in 2001.
- This provision effectively means corporate profits tax may be low or zero.
- Interest is tax deductible in Ireland, but because the interest payment may vary, it is generally deemed to be dividend income when paid abroad, and thus tax free, as it is a distribution of profits, which have already been subject to tax.
- An earlier study (Stewart and Doyle, 2017) identified most of the population of 's. 110' firms and has been updated since then.
- From this population 194 firms registered in Ireland were identified with available accounts that
 - (1) were trading
 - (2) engaged in aircraft leasing
 - (3) Availed of s. 110 finance
- Nineteen firms were excluded as they were subsidiaries of other identified s. 110 firms.
- Resulting in a study population of 175

Some features of the study Population

- In most cases the study firms can be described as using an operating lease, this means the aircraft subject to a lease appear in the balance sheet of the lessor and associated costs such as depreciation are shown.
- Some firms in the study use what is described as a 'finance' lease defined as where all the risks and rewards are transferred to the lessee (Deloitte, 2014, p. 6).
- Pre tax profits can be highly variable reflecting gains from the sale of aircraft, and gains/charges associated with revaluation of subordinated debt.
- Some firms in the study had subsidiaries.
- These subsidiaries were excluded from the study if they had already been identified as 's. 110' firms.
- In some cases firms included had subsidiaries operating in other countries and asset values reflect their inclusion.

A Case Study: Merx Aviation Finance

- Non leasing revenue accounts for 41% of total revenue
- Pre tax profits are \$46.4 million If interest on PPL is regarded as a distribution pre-tax profits

\$ Million March 2018

Lease Income	64.3
Interest Income	21.4
Gain on disposal	7.3
Redelivery income	16.9
Total	109.9
Expenses	
Finance Expenses	73.0
Of which PPL	52.5
Salary cost	1.3
Includes accrued bonus of	0.76
Loss before Tax	-6.1
Share in Joint venture	12.0

A Case study: Merx Aviation Finance

- Assets are large as are borrowings
- PPL provides 32% of debt finance but accounts for 71% of interest paid.

\$ Million March 2018

Total assets	729.7
Loans and borrowings	508.5
PPL ('section 110')	164.4

Study Group Gross Assets and their Financing (\$ million)

- The Table shows rapid growth in assets and 's. 110 debt since 2011. The table also shows shareholder funds are a small part of total assets.

Year	No.	Value of Assets	Value of Profit Participating loans	Security /maintainance reserves	Shareholder Funds
2017	128	14362	4551	854.7	138.914
2016	131	13140	4916	986.3	135.349
2015	118	11029	3913	674.7	68.100
2014	60	8065	2955	416.6	35.780
2013	40	5464	1466	342.0	27.387
2012	17	1844	865	143.9	19.516

Study Group Aggregate, Revenues, Interest Payments and profits (\$ m.)

- Interest payments vary between 45% and 60% of revenues.
- PPL interest averages around 9% of outstanding loans.
- In aggregate the firms included reported losses for most years. However if interest on the PPL is regarded as a distribution, rather than a charge, aggregate profits are positive. Most firms do not report cash tax paid, but it is likely that cash tax payments are zero or minimal for most firms.

Year	N	Revenues	Total Interest payments	Interest on PPL	Pretax profits
2017	128	1785.2	834.2	442.6	-143.9
2016	131	1467.6	926.4	431.6	-32.5
2015	116	1721.1	582.4	360.5	93.6
2014	60	905.3	400.1	264.9	-34.1
2013	38	576.4	312.4	188.5	-17.9
2012	17	233.6	106.8	85.3	-13.0

Proposed Policy Responses The Green New Deal

The Commission (2019, p. 19) proposals in relation to a 'Green New Deal' state:-

- “The commission will look closely at the current tax exemptions including for aviation and maritime fuels and at how best to close any loopholes”.
- The Commission announced a target of a “climate neutral EU by 2050”.
- It is proposed that this target will be underwritten by a ‘European Climate Law’
- More recently the President of the European Commission has proposed:-
- That these measures pass using what are termed ‘passerelle clauses’ that will not require Treaty Change.
- The unanimity principle at the European Council is required and may pose difficulties
- What are termed ‘enhanced cooperation’ (a minimum of 9 member states) would still result in substantial change.
- The finance ministers of Germany, France, the Netherlands, Sweden and five other EU states appealed for “some form of aviation tax”.
- The Anti Tax Avoidance Directive could also affect s. 110 financing requiring greater substance.
- However Tax experts have also stated that “while challenges remain, Irish structures continue to provide compelling benefits for aircraft ownership”

Conclusions

- S. 110 financed aircraft leasing firms have minimal economic impact
- Almost no direct employees,
- Economic impact is via bought in services CSR, auditing and legal advice.
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- Cost a lot in terms of tax expenditures
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- An important issue is how whether changes in hybrid rules reduce attraction of Ireland as a location for aircraft leasing.
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- The tax regime of aircraft leasing in Ireland is unlikely to be consistent with requirements under the Green New Deal proposed by the Commission.
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