सत्यमेव जयते

Ministry of Civil Aviation
Government of India

PROJECT RUPEE RAFTAAR

Development of Aircraft Financing and Leasing in India

Report of the Working Group

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Government of India
Ministry of Civil Aviation
Economic Regulation Division

Rajiv Gandhi Bhavan, Safdarjung Airport
New Delhi - 110003
er-sec.moca@nic.in

FOREWORD

Recognizing the criticality and untapped business potential within aircraft financing and leasing activities in India and for providing a stimulus to exports, economic growth and employment, a Working Group on Developing Avenues for Aircraft Financing and Leasing Activities in India was constituted by Ministry of Civil Aviation in May 2018 to recommend measures for developing this industry in the country. The Working Group comprised of diverse stakeholders from across the government, regulatory authorities, public and private corporates, industry associations, academia, and legal and financial consultants. It held multiple interactions across the aviation ecosystem in India and abroad.

This Report provides a roadmap for developing aircraft financing and leasing as an asset class from institutional investors in India so that entities are better enabled to seize the emerging opportunities arising for aircraft financing and aircraft leasing from the growth and development of the civil aviation sector.

The recommendations draw upon a detailed and exhaustive 360-degree review and examination by the Working Group of the regulatory framework and procedural aspects, including with regard to direct and indirect taxes and other duties and import and re-export provisions. The institutions covered include banks, financial institutions (such as insurance companies, pension funds, provident funds, other alternative investment funds), lessors and asset managers, and high net-worth individuals.

Proposed structure has been identified that would provide a platform to set up India's first companies whose primary business is the undertaking of aircraft financing and/or aircraft leasing activities in the International Financial Services Centre (IFSC) notified by the Government of India under the Special Economic Zone Act, 2005. Changes to the provisions have been suggested after identifying, and where possible quantifying, the inefficiencies in the existing ecosystem in India, and notably in the IFSC, vis-à-vis the regulatory regimes of the leading global aircraft financing hubs such as in Dublin (Ireland), Singapore, and Hong Kong and Tianjin (China).

Recognising that leasing has become a more cost-effective option for airlines, a financial model for a typical albeit complex “Sale and Lease Back” transaction popularly used by Indian scheduled airline operators has been developed in order to hone up the understanding of changes that are desirable to enhance the attractiveness of IFSC in India as an aircraft financing hub. Underscoring this is the fact that recourse to operating and financial lease by Indian airlines has enabled expansion within the airline industry, including the growth of Low-Cost Carriers, despite significant increase in the cost of an aircraft especially after the industry transitioned to jet planes. This expansion in turn has helped to spur unprecedented growth of affordable air travel in India.

Given the off-shore status of IFSC with the same ecosystem as other offshore locations but which is physically on Indian soil, the recommendations would also be relevant and apply to transactions entered into with Indian entities by airlines across the world.

The Report finds that the time to add India on the map of global financial centres for international financial services has come, and that the opportunity must be seized now without any delay or half measures. This need was impressed upon the Working Group by airlines, financiers, insurers, lessors, and other stakeholders alike and without reservations of any kind to develop the system holistically.

The immediate and direct benefits to India would include developing this business in India and retain foreign currency in the country and at the same time develop options for rupee funding through various structures, besides generating additional revenues through collection of taxes from ancillary industries and eventually through aircraft financing. Significantly, a new line of business would be developed which by its nature would create additional high-end job opportunities in India. It would mean substantial additional business for Indian banks, insurers, NBFCs and other ancillary business (law firms, accounting firms etc.) through an estimated 100 aircraft to be acquired each year over the next decade entailing financing requirement of about USD 5 billion annually.

Procedurally, the Working Group held group-wise and one-one-one consultations to cover the whole aircraft acquisition industry and regulators in India, including Reserve Bank of India. A comprehensive initial Discussion Draft on Regulatory Assessments was developed by M/s Trilegal along with initial financial and leasing model by Purvi Maheswari. After incorporating the inefficiencies and key asks, the final financial and leasing modelling was carried out by M/s PricewaterhouseCooper. A small group comprising of the Chairperson and Member Secretary, and Members Dipesh Shah, Purvi Maheshwari, Ajay Kumar, and Vinod Kothari, interacted with these legal and financial advisers and simultaneously reached out to airlines, banks, financiers, insurers, lessors/ asset managers, OEMs, and potential stakeholders. Detailed discussions were held in Dublin with overseas lessors. The advances made by this group were periodically reported to the Working Group for guidance and finalisation of issues. Discussions were also held with associated Ministries/Departments of Government of India and regulators including the Reserve Bank of India and Insurance Regulatory and Development Authority of India to elicit their considered views on the draft discussion documents from time to time.

The Working Group had the privilege of continuous and detailed guidance from Shri Suresh Prabhu, Hon'ble Minister of Civil Aviation, Shri Jayant Sinha, Hon'ble Minister of State for Civil Aviation and Shri Rajiv Nayan Choubey, Secretary, Ministry of Civil Aviation. Shri Sudhir Mankad, Chairman, GIFT-City, Gujarat and Shri Ajay Pandey, MD & Group CEO, GIFT City also supported the venture and deliberations.

This Report would not be complete without acknowledging the unstinting and able assistance provided by Dinesh Kumar, Deputy Director and other Officials and Staff of the Economic Regulation Division in the Ministry. The Working Group extends its gratitude to them.

In conclusion, this Report provides policy makers with suitable inputs for developing aircraft financing and leasing activities in India and implementing appropriate interventions for setting up this new industry in India. In many parts of India and the world air travel is a new luxury while in many cases a necessity. By playing a very significant direct role in helping airlines make air travel affordable and accessible to the growing population of first time air passengers, this aviation financing and leasing avenue in India has the potential to enhance employment opportunities, increase FDI inflows and contribute immensely in and harness the indirect, induced and catalytic benefits of the entire ecosystem of aircraft financing and leasing in India for the overall growth of India's GDP, including significantly improving the current account balances in India's trade in international financial services. This Report contributes to the vision of the Honourable Prime Minister of India for making IFSC a hub for international financial services and position India suitably in the global financial world. It also provides a robust foundation for realising the policy intent, stated in the Union Budgets (2015-16 and 2016-17) presented by the Finance Minister, of making IFSC at GIFT-City at least as good its counterparts in Singapore and Dubai and outlines the way forward for realising the transformational potential of India's demand for aircraft financing and leasing.

Vandana Aggarwal

Vandana Aggarwal
Economic Adviser (Economic Regulation)
Ministry of Civil Aviation Government of India
Chairperson

Ved Prakash
Director
Directorate General of Civil Aviation
Government of India
Member

Pankaj Jain
Joint Secretary
Department of Financial Services
Government of India
Member

Mrutyunjay Behera
Economic Adviser
Department of Economic Affairs
Government of India
Member

Sangeeta Saxena
Director (TPD)
Department of Commerce
Government of India
Member

G.S. Negi
Economic Adviser
Department of Industrial Policy & Promotion
Government of India
Member

K.V.R. Murthy
Joint Secretary (Policy)
Department of Corporate Affairs
Government of India
Member

Manish K. Sinha*
Joint Secretary (TRU-II)
Central Board of Indirect Taxes & Customs
Government of India
Member

Rashmi Ranjan Das
Joint Secretary (TPL-I)
Central Board of Direct Taxes
Government of India
Member

Dipesh Shah
Chief, International Financial Services Centre (IFSC)
Gujarat International Finance Tec City Corp. Ltd.
Member

Ajay Singh
Chairman
CII National Committee on Aviation, and
CEO, SpiceJet Ltd.
Member

Pratyush Kumar
Former Chairman
FICCI National Aviation Committee, and
President, Boeing India Ltd.
Member

Anand Stanley
Chairman
FICCI Committee on Civil Aviation, and
President & MD, Airbus
Member

Vinod Kothari
Chairman and Managing Director
Vinod Kothari Consultants
Member

Prof. Sanjay Sehgal
Head
Department of Financial Studies
University of Delhi
Member

Ajay Kumar
Partner
Rajinder Narain & Co.
(Consultants and Legal Advisers)
Member

Vinod Hejmadi
Director (Finance)
Air India Ltd.
Member

Amit Agarwal
Deputy Chief Executive Officer & CFO
Jet Airways Ltd.
Member

Krishan Bhargava
Vice President (Aircraft Financing)
Interglobe Aviation Ltd. (IndiGo)
Member

Purvi Maheshwari
Senior Director
Boeing Capital Corporation
Seattle
Member

Angshumali Rastogi
Director (Economic Regulation)
Ministry Civil Aviation
Government of India
Member-Secretary

Note: *Members have served on this Working Group ad personam. Comments, views, analysis and/or examination herein are neither attributable nor are the recommendations binding upon the organisations to which the Members belong. Reserve Bank of India was represented variously by the Officers from Delhi Office.*

* *Recused himself from the recommendations on indirect taxes.*

Dated: 10.01.2019

CONTENTS

LIST OF ANNEXES

ABBREVIATIONS AND ACRONYMS

AAI	:	Airports Authority of India
AAIA	:	Airports Authority of India Act, 1994
AIF	:	Alternative Investment Funds
Aircraft Act	:	Aircraft Act, 1934
Aircraft Rules	:	Aircraft Rules, 1937
ATF	:	Aviation Turbine Fuel
BR Act	:	Banking Regulation Act, 1949
BCD	:	Basic Customs Duty
CAGR	:	Compound Annual Growth Rate
CARs	:	Civil Aviation Requirements
Central Government	:	Government of India, acting through the relevant ministry or administrative wing
CGST	:	Central Goods and Services Tax
Companies Act	:	Companies Act, 2013
CST	:	Central Sales Tax
DDT	:	Dividend Distribution Tax
DGCA	:	Directorate General of Civil Aviation (i.e. the regulatory body for civil aviation in India)
DTA	:	Domestic Tariff Area
DTAA	:	Double Taxation Avoidance Agreement
FEMA	:	Foreign Exchange Management Act,1999
FEMA IFSC Regulations	:	Foreign Exchange Management (International Financial Services Centre) Regulations, 2015

GAAR	:	General Anti Avoidance Rules
GDP	:	Gross Domestic Product
GIFT	:	Gujarat International Finance Tec-City
GPA	:	Guinness Peat Aviation
GSA	:	Gujarat Stamp Act, 1958
GST	:	Goods and Services Tax
HNIs	:	High Net Worth Individuals
IATA	:	International Air Transport Association
IFC	:	International Finance Centre
IFSC	:	International Financial Services Centre
IGST	:	Integrated Goods and Services Tax
IIO	:	International Financial Service Centre Insurance Offices
ILFC	:	International Lease Finance Corporation
INR	:	Indian Rupees
Insurance Act	:	Insurance Act, 1938
Insurance Regulations	:	IRDAI (Investment) Regulations, 2016
IRDAI	:	Insurance Regulatory and Development Authority of India
ISA	:	Indian Stamp Act, 1899
IT Act	:	Income Tax Act, 1961
LCC	:	Low Cost Carrier
LLP	:	Limited Liability Partnership
MAT	:	Minimum Alternate Tax
Master Directions (Financial Services by Banks)	:	Master Directions - Reserve Bank of India (Financial Services provided by Banks) Directions, 2016
MOCA	:	Ministry of Civil Aviation

MOF	:	Ministry of Finance
MRO	:	Maintenance, Repair and Overhaul
NBFC	:	Non-Banking Financial Company
NCAP	:	National Civil Aviation Policy, 2016
NCLT	:	National Company Law Tribunal
NFE	:	Net Foreign Exchange
NPS	:	National Pension Scheme
OEM	:	Original Equipment Manufacturer
PFRDA	:	Pension Fund Regulatory and Development Authority
RBI	:	Reserve Bank of India (i.e. the central banking regulator in India)
RCS	:	Regional Connectivity Scheme
RFP	:	Request For Proposal
SARFAESI	:	Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest
SEBI	:	Securities and Exchange Board of India (i.e. regulator for the securities market in India)
SEBI (AIF) Regulations	:	SEBI (Alternative Investment Funds) Regulations, 2012
SEBI (IFSC) Guidelines	:	SEBI (International Financial Services Centres) Guidelines, 2015
SEZ Act	:	Special Economic Zones Act, 2005
SGST	:	State Goods and Services Tax
SPC	:	Special Purpose Company
SPV	:	Special Purpose Vehicle
UDAN	:	Ude Desh ka Aam Naagrik
USD	:	United States Dollar
VAT	:	Value Added Tax

EXECUTIVE SUMMARY

India has emerged as an aviation major with swift governmental policy and regulatory interventions. These include the National Civil Aviation Policy 2016, increased Foreign Direct Investment (FDI) in domestic airlines, and heightened focus on regional connectivity (*Ude Desh ka Aam Naagrik-UDAN*) which has led to new airports and induction of newer types of aircraft, and Open Skies. Fuelled also by improving economic environment like increasing middle class, growth in cross-border trade, development of world class airports, declining fuel prices, and capacity expansion of low-cost carriers (LCCs), India is currently the third largest domestic passenger market. It is projected to advance rapidly from its current seventh position in terms of the combined domestic and international passenger market of over 200 million passengers (to, from and within India) in 2018 to also become the third largest worldwide by 2022.

The Indian civil aviation market has been growing at a high pace for the past several years, clocking an unexpected recovery since 2014 coupled with an unprecedented double-digit growth consecutively for the past 51 months. This has changed the dynamics of the market and the demand for aircraft. The strong financial performance of airlines was enabled by various factors including declining fuel costs, increased aircraft utilisation, more effective revenue management with double-digit air freight growth, greater pricing discipline, and a buoyant economy with GDP growth of around 7% per annum.

Coupled with strong demand fundamentals and high liquidity in aircraft financing, airlines have placed orders for more than 1,000 aircraft, making it the third largest order book in the world behind only the United States and China. Though some erosion in airline yield was seen during the first two quarters of 2018-19 due to adverse movements in currency and fuel prices coupled with a surge in the low-cost/ long-haul market due to unprecedented affordability of airline tickets, the outlook remains positive and green shoots of rising yield are visible. Going forward, as per recent industry projections the passenger traffic is expected to grow six-fold to around 1.1 billion by the year 2040, serviced by a scheduled airline operator fleet which would grow from about 620 aircraft in March 2018 to around 2,350 by March 2040. As per predictions of Airbus and Boeing, in the next 20 years, India will need 1,750-2,100 aircraft valued at over ₹ 20,40,000 crore (~USD 290 billion), with an estimated 100 deliveries each year, i.e. about ₹ 35,000 crore or USD 5 billion of financing each year.

Globally also, long-term air traffic growth has been driving the demand for aircraft. A significant proportion of the projected doubling of the current global aircraft fleet of 29,841 over the next 20 years at an estimated USD 6.1 trillion market value are for fleet growth.

The time is ripe to align India's aircraft/ engine rupee-financing and high-value asset leasing regime with the jurisdictions holding global centre-stage like Ireland, Singapore, the US, and China. Indian airlines have so far participated in this ecosphere for the most part as a consumer of international financial services, depending almost entirely on international financiers for financing their acquisition of aircraft on export credit, loan and/or lease basis with negligible participation from Indian institutions. In India, over 70% of the aircraft acquisitions over the last decade have been on an operating lease basis and the trend is expected to continue. Globally also, since its inception in the early 1970s, aircraft leasing has grown from an estimated 2 per cent in 1980 growing to about 41 per cent of in-service commercial aircraft ownership in 2018.

The Government of India in the Ministry of Civil Aviation vide its Order dated 22.05.2018 and Addendum dated 05.06.2018 constituted a Working Group for the "Development of Avenues for Aircraft Financing & Leasing Activities in India". Its terms of reference, *inter alia*, included examining and recommending changes along with potential strategies for making aircraft financing and leasing activities more attractive for entities set up in GIFT-City International Financial Services Centre (IFSC).

The Working Group has carried out a 360-degree review of current regulatory framework affecting such activities and held a series of stakeholder consultations as a part of this review. The leasing and financing processes have become more complex and time-consuming not just due to the associated delivery and redelivery processes, but also because the competitive pressures among lessors are driving in offers of customised leasing products for the airlines. It has thus identified challenges, many of which arise because the lessor and the lessee look at the lease from different perspectives, and barriers, including detailing out inefficiencies. It has worked out potential solutions, with detailed analysis and Draft Texts of legal and regulatory changes recommended herein, for the consideration of the competent authority concerned.

It was observed that aircraft financing is the most profitable segment of the aviation value chain. Currently, foreign financiers and lessors are the biggest beneficiaries of India's growing pie. It is vital to develop this new line of business in India for financial services and add India on the map of global financial centres for international financial services. This would create additional high-end jobs' opportunities in India not only directly through aircraft financing, but also ancillary jobs in industries such legal, accounting, etc. At the same time, it would provide an impetus to the sustainable development of a robust Maintenance, Repair and Overhaul (MRO) industry in India which is better positioned to service the growing demand of an expanding fleet, engines and other critical parts. It is also germane that the investments in new generation aircraft with advanced technology will pose both opportunities and challenges for new lessor entrants, not least also for established lessors whose business model is to operate similar assets (mostly Airbus and Boeing aircraft, and mostly narrow bodies) and those who market to a similar airline client base. For instance, based on the order book of airlines, the share of new technology aircraft (e.g.: A320neo, B737MAX, A330neo, A350 and B787) would reach up to 58% of the fleet share by 2027. Digitalization of aircraft operations and the common use of big data analytics to support maintenance programmes and planning (predictive maintenance) related issues would also need to be taken up separately by the competent authority concerned in due course of time for ensuring the sustainability of the new business of aircraft financing and leasing from India.

This positive growth outlook for aircraft leasing and finance industry makes it worth exploring and developing in India. However, learning from the experiences of the leading global leasing centres like Ireland, Singapore, US, and China, India must identify and rectify the key bottlenecks to the sector. In order for India to become a favourable destination for aircraft leasing business, various factors such as tax benefits, and availability of diversified sources of finances for the lessors, withholding tax and double tax avoidance agreements, and exposure to foreign exchange risk need to be addressed.

The Working Group found that as India embarks on a mission to establishing an aircraft financing and leasing industry, to attract competitive financing, leasing, insurance, credit guarantees, and associated activities, it would be both efficient and effective to focus on the global market leader Ireland's blueprints for the regulatory framework to be introduced in India. Ireland has concertedly established a regime by entering into double-tax avoidance treaties which support key aspects of aircraft financing and leasing with over 70 countries. Coupled with a tax credit policy for non-treaty countries, low corporate tax rate on leasing companies, provision for accelerated depreciation on aircraft, and a supportive skills development system, the Working Group found that Ireland's aircraft lessor business model has been proven to be a resilient one over the last several decades with several years of placement visibility, and swift repossession of aircraft from a financially-strained airline and redeployment elsewhere in the world. Ireland is a signatory to the Cape Town Convention (CTC 2001). Of the world's entire fleet of leased aircraft, over 50% of them are managed through Irish companies.

Aircraft financing is done globally from an international financial centre as it provides a highly competitive regulatory framework to support such business. Under the Government of India's initiative of International Financial Services Centre (IFSC) in India it was found that IFSC at GIFT City, Gujarat, the sole IFSC in the country, would provide a valuable platform, with a regime already more in line with other global financial centres, to host these activities efficiently. Practically speaking, therefore, the Working Group concluded that the IFSC at GIFT-City, which has off-shore status for financial services to non-residents and residents to the extent permissible under the current regulations in any currency except the Indian Rupee, important income tax incentives, company law exemptions and dispute resolution mechanism provides the opportune jurisdiction to launch this business from.

The Hon'ble Prime Minister has provided the vision for the GIFT-City IFSC: *"The concept of an International Financial Services' Centre is simple but powerful. It aims to provide onshore talent with an offshore technological and regulatory framework. This is to enable Indian firms to compete on an equal footing with offshore financial centres. GIFT City IFSC will be able to provide facilities and regulations comparable to any other leading international finance centres in the world"*.

Accordingly, the Government of India has already provided various regulatory and tax support for the IFSC, which have been listed out in the detailed Section on IFSC. This enabling framework holds the key for hosting the aircraft acquisition, financing and leasing business in India. Considering the same, the Working Group has detailed out the key regulatory changes required in the existing regulations for IFSC issued by RBI, SEBI, and IRDAI, besides other legal and regulatory, including in direct and indirect taxation, required to be carried out by various Ministries/ Departments and other regulators concerned. All identified barriers and regulatory changes, including their implications, have been detailed out in Section-9 of this Report and the principal ones have been highlighted in Section-4.

Additionally, drawing upon global experiences, the Working Group has proposed a structure for developing aircraft financing and leasing activities by interested banking, non-banking, insurance or any other financial or asset management companies, foreign lessors, and start-ups in IFSC in India. The leasing company could be set up in IFSC under the NBFC regulations, proposed by IFSC which are in an advanced stage of consideration in RBI, for carrying out leasing and financing business. The financial model for the proposed structure has also been outlined. The proposed structure would make India more favourable and competitive place for carrying out aircraft leasing & financing business from IFSC.

Aircraft operating leasing offers stable and predictable cash flow and hence, is a profitable sector for investors' money. This sector which is missing in India today has a potential to contribute to the growth of the economy in form of higher tax revenue collections, new employment opportunities and affordable air travel for citizens. The Report looks at the potential of aircraft leasing industry in India and it provides complete framework with all regulatory changes required along with the structure to implement the initiative in India. The Report lays emphasis on the need to provide complete set of changes to achieve the desired result and that partial changes to regulatory framework would not help to set up this new industry in the country. It is recommended that the Government of India and the State Government of Gujarat should take adequate short-term and long-term reformative measures coupled with policy incentives to set up a robust aircraft leasing industry in the country.

PRINCIPAL RECOMMENDATIONS IN SUMMARY

3.1 Overview

The Working Group has carried out a 360-degree review of current regulatory framework affecting such activities and held a series of stakeholder consultations as a part of this review. It has thus identified challenges, many of which arise because the lessor and the lessee look at the lease from different perspectives, and barriers, including detailing out inefficiencies. As India embarks on a mission to establishing an aircraft financing and leasing industry, to attract competitive financing, leasing, insurance, credit guarantees, and associated activities, it would be both efficient and effective to focus on the global market leader Ireland's blueprints for the regulatory framework to be introduced in India. Keeping this comparative in view, the Working Group has worked out potential solutions, with detailed analysis and Draft Texts of legal and regulatory changes recommended herein, for the consideration of the competent authority concerned. A summary of the principal recommendations is provided herein.

By way of a brief background, it is stated that each financing source is susceptible to both credit market and regulatory shocks which can reduce the supply and increase the cost of financing. Compared to typical commercial bank loans, by and large lessors have been able to qualitatively tailor their lease product to offer more competitive rates besides addressing the specific lessee requirements. Structuring an operating lease allows an airline to enjoy all the benefits of aircraft ownership for a fraction of the initial cash outlay. It keeps debt off the airline's books. The Sale-and-Lease-Back (SLB) model allows the airline to make a profit on the aircraft sale value even before it flies. The airline can upgrade, replace or return the aircraft during the lease period.

While global capital markets saw an overall decline in activity in 2017, according to Boeing Capital's Current Airfinance Market Outlook – partly due to airlines deleveraging risk and greater access to bank debt – they still accounted for more than USD 60 billion of funding competitively priced at around 4.1%, of which lessors accounted for 70%. Lessors worldwide focused predominantly on raising unsecured paper, which gives businesses flexibility in more uncertain times. More recently, a wave of new money has been pouring into operating leasing and exerting pressure on lease rates, mainly in SLBs of new aircraft and among emerging lessors. As per a study[1], the aircraft leasing market size is estimated to increase to USD 62 billion (~₹ 4,34,000 crore) by 2023 recording a compound annual growth rate (CAGR) of 4.7% from 2017 to 2023.

[1]Global Aircraft Leasing Market Research Report – Forecast to 2023: Market Research Future, December 2017.

The aircraft lessor business model has been proven to be a resilient one over the last several decades with several years of placement visibility, and swift repossession of aircraft from a financially-strained airline and redeployment elsewhere in the world. It is a macro driven sector designed to deal with pockets of volatility: Fleets are large, and they are diversified by aircraft type, customer, geography, and lease term, which insulates cash flows during a downturn as long as liabilities are well-managed. Even during the global financial crisis, aircraft lessors' fleet utilisation was above 96% on average. The total value of the portfolio of 9,225 aircraft, including regional jets, of the top-50 lessors was USD 280 billion in 2018[2]. The same report finds that while European lessors increased their managed fleet from 25% to 39% during the decade ending in 2017, the centre of gravity for the aircraft leasing sector is migrating from the large Western jurisdictions towards the Asia-Pacific region whose share increased from 5% to 19%. Currently, 4 of the top 10 aircraft leasing companies in the world are backed by Chinese banks/ financial institutions.

As per IATA, airlines spent USD 67.6 billion in 2016 on Maintenance, Repair and Overhaul (MRO), a large part of which is typically channelled through the aircraft/ engine lease agreement. The contribution of Indian MRO entities to this market domestically is currently about USD 800 million as per estimates of the MRO Association of India. Engine and components remain the highest cost segments with respectively 41% and 23% of MRO financing needs. With a 5.1% increase per annum, the global MRO market size is estimated to reach USD 100.6 billion in 2026. Indian entities are projected to provide MRO services in India and abroad increasing from USD 1.8 billion in 2017 to about USD 3.2 billion in 2027. These trends highlight the rate at which the aircraft leasing business is growing across the globe and clearly make the potential of aircraft/ engine leasing industry, with the ancillary development of MRO, worth exploring for India too.

[2]Special Report, Finance & Leasing 2018: Flight Global.

3.2 Key Regulatory and Policy Asks for Aircraft Financing and Leasing Activities in IFSC in India

Particulars	Ireland	IFSC	*Beneficiary*	*Asks*
Corporate Tax Rate	12.5% (However, group consolidation allowed)	• Exemption available – 100% (first 5 years) and 50% (next 5 years) (However no group consolidation allowed) • 34.94% (11th year onward)	Lessor	**Tax benefit should commence at the option of the lessor for a 10-year period within a block of 15 years**
			Airline	**Lease rentals paid to lessor based in IFSC should be eligible for a weighted deduction of 125%**
Minimum Alternate Tax (MAT) - Lessor Company	Not applicable	Book profits (tax @ 10.48%)	Lessor	**Exemption / relaxation from MAT**
Tax Depreciation Allowance	Allowed to depreciate the aircraft cost over 8 years	Allowed to depreciate aircraft for MAT computation over 20 years	Lessor	**Enhanced depreciation under Companies Act by reducing the useful life of the asset (8 or 12 years)**
Interest Expense on Aircraft Loan/ Intercompany Funding	Deductible on arms' length payments	Deductible on arms' length payments	Lessor	
Withholding Tax (WHT) on Interest Payment by Lessor Company/ Special Purpose Vehicle (SPV)	20% (exemption on payments to 'Qualifying lender') Typically, 'zero' WHT	Interest to domestic parties – 10% Interest to non-residents – Typically 10/15% in tax treaties	Lessor	**Exemption from WHT on interest payments to non-residents**
WHT on Lease Rentals	Nil on aircraft (Ireland) Nil on engines (in The Netherlands)	In the absence of a favourable DTAA, ▪ 2% on aircraft going up to 40% ▪ On engines up to 40%	Airline	**Exemption from WHT [Note: under DTAA, lease rental payments constitute 'business profit' and are taxable only in Ireland}]**
Goods and Services Tax (GST) on lease rentals in the case of domestic leasing company	5%	5%	Airline	**Exemption from GST**
IGST on import of aircraft by Indian leasing company	5%	5%	Airline	**Exemption from GST; Nil BCD**
Taxable Base	Gross rentals less deductible expenses including depreciation allowance: Not taxable (due to depreciation allowance provisions)	Gross rentals less deductible expenses including depreciation allowance: Not taxable under normal tax computation; Taxable on 'book profits' under MAT	Lessor	
Disposal of Aircraft	Taxable as business income (up to original cost; excess gains taxable as capital gains)	Being a depreciable asset, capital gains are subject to 34.94% (approx.)	Lessor	**Exemption from short term capital gains tax**
Stamp Duty	Nil	Applicable	Lessor and Airline	**Exempt stamp duty on lease rental and sale agreement**

3.3 Key Regulatory and Policy Asks by Relevant Authority

AUTHORITY	CHANGE WRT	PROPOSED CHANGES
RBI	Banks	• Confirmation that 'equipment' under the S. 6(1)(o) notification (issued under the BR Act) dated August 14, 1984 and under the Master Directions (Financial services by banks) 2016 includes aircrafts • Amend the IBU Circular governing permitted activities by banks in GIFT City (a) to allow banks to undertake 'equipment leasing' (b) to invest in capital of SPVs undertaking aircraft leasing, and (c) to establish SPVs for aircraft financing
	NBFCs	• Clarify that aircraft leasing would be eligible to register as NBFCs (whether financial lease or operating lease) under S. 45I(c) of the RBI Act, 1934 • Notify framework/ regulations for NBFCs to set up/ operate in GIFT City (framework to also allow NBFC operations in GIFT City to invest/ finance in SPVs engaged in aircraft leasing) and also clarify that entity earning only operating lease rental is eligible for NBFC license under the FEMA (IFSC) Regulations, 2015
	AIFs/ HNIs	• Clarification whether investment by AIFs in the DTA into GIFT City SPVs would qualify as domestic or overseas investments under the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 • Exclusion of investments by domestic AIFs in GIFT City SPVs from the overall cap of $500 million under the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 • Liberalize fund raising alternatives from resident investors for AIFs in SPVs/ GIFT City (relax USD 250,000 cap for Indian HNIs investing into AIFs and mutual funds in SPV/ GIFT City, clarification on the scope of 'institutional investors' under the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 • Specifically allow AIFs to invest in debt securities issued by NBFCs established in GIFT City under the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004
	Mutual Funds	• Clarification whether investment by mutual funds in DTA into GIFT City SPVs would qualify as domestic or overseas investments under Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 • Issue circular under Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 to permit mutual funds to invest in unlisted equity of foreign entities which are NBFCs in GIFT City • Relax restrictions under Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 (applicable to foreign debt securities which are rated) for debt investments by Mutual Funds into NBFCs in GIFT City • Permit investment by MFs in unlisted equity and foreign debt securities of NBFCs in GIFT City • Liberalize fund raising alternatives from resident investors for mutual funds in GIFT City
RBI (contd.)	Foreign Lenders (for PDP financing under the ECB route)	• Issue specific directions under Section 11 of Foreign Exchange Management Act, 1999 to relax the minimum average maturity period and the 'all in cost ceiling' for airlines seeking to access this route for PDP Financing • Recognize leasing/ financing SPVs in GIFT City as 'eligible lenders' under the ECB Master Directions; or permit such entities to extend financing to airline companies outside the ECB route .
	Foreign Lenders (for PDP financing under the Trade Credits route)	• Amend the $20mn cap where the end use of the trade credit is PDP financing for aircrafts under the ECB Master Directions. • Relax the all-in-cost ceiling, for PDP financing of aircrafts • Recognize leasing/ financing SPVs in GIFT City as eligible lenders for extending trade credits; or permit such entities to extend trade credits outside the existing ECB Master Directions • Clarification to permit airline operator to avail PDP financing by way of trade credit despite leasing entity in GIFT City being the importer of the aircraft.
	Stamp Duty	• Amend the Gujarat SEZ Act to provide complete exemption from payment of stamp duty (action on this will also be required by the Government of Gujarat and MoF).

AUTHORITY	CHANGE WRT	PROPOSED CHANGES
Ministry of Finance	Banks	• Notification under Section 6(1)(o) of the BR Act specifying aircraft financing/ leasing as a permitted activity for banks • Issue a new notification under the S. 19(1)(c) of the BR Act to permit bank subsidiaries to undertake aircraft financing for 'public interest' or to 'spread banking business in India'
	Insurance Companies	• Using special dispensation powers under S.2CA of the Insurance Act to exempt insurers from the restriction on investment in private companies for investments made into entities located in IFSCs • Notification under S.2CA of the Insurance Act to exempt insurance companies in GIFT City from the restriction on overseas investment
SEBI	AIFs	• Liberalize the SEBI (AIF) Regulations with respect to the 25% concentration limits for investments by domestic AIFs into SPVs engaged in aircraft leasing or • Create a separate category of AIFs targeting investment into SPVs for aircraft leasing • Clarification whether investment by domestic AIFs into GIFT City SPVs would qualify as domestic or overseas investments under the SEBI Circular dated October 1, 2015
	Mutual Funds	• Liberalize the SEBI (Mutual Funds) Regulations with respect to the NAV based concentration limit for investments by domestic mutual funds into unlisted debt or equity of SPVs engaged in aircraft leasing or • Create a separate category of scheme for mutual funds targeting investment into SPVs engaged in aircraft leasing
IRDAI	Insurance Companies	• Clarify that investment into GIFT City SPVs would not attract the restrictions on overseas investments using Indian policyholders' funds • Amend the IRDAI (Investment) Regulations to permit IIOs to invest in unlisted debt securities of private companies undertaking aircraft leasing and relaxation for investment in listed debt securities • Amend list of permitted equity investments by insurance companies as prescribed by IRDAI • Include aircraft financing in the categories of business activities permitted for IIOs under the IRDAI (Registration and Operations of IIO) Guidelines, 2017
PFRDA	Pension Funds	• Clarification under the PFRDA Act on whether investment of subscribers fund into AIFs, who may invest in GIFT City SPVs engaged in aircraft leasing is domestic or overseas investment • Amendment to investment guidelines to allow pension funds to invest in equity or debt of private companies
Ministry of Finance CBIC – GST Council	GST on import	• Amend Serial Number 540 (and condition 78) of Notification 50/2017-Customs to provide BCD and IGST exemption on import of aircraft by a leasing company. Leasing company to be included in definition of "operator" or • Amend notification 65/2017-Customs to extend IGST exemption to aircraft imported on lease to enable SLB by an Indian leasing company. This is require removal of re-export and non-transfer obligations [conditions (ii) and (iii)] (at least, if the lessor is an Indian leasing company) • Specific exemption to be provided in respect of IGST on lease rentals charge by an Indian leasing entity • Remove specific entry for leasing of aircrafts (entry iv of Notification 8/2017-Integrated Tax-Rate) as this restricts credit of GST paid on purchase of aircraft.

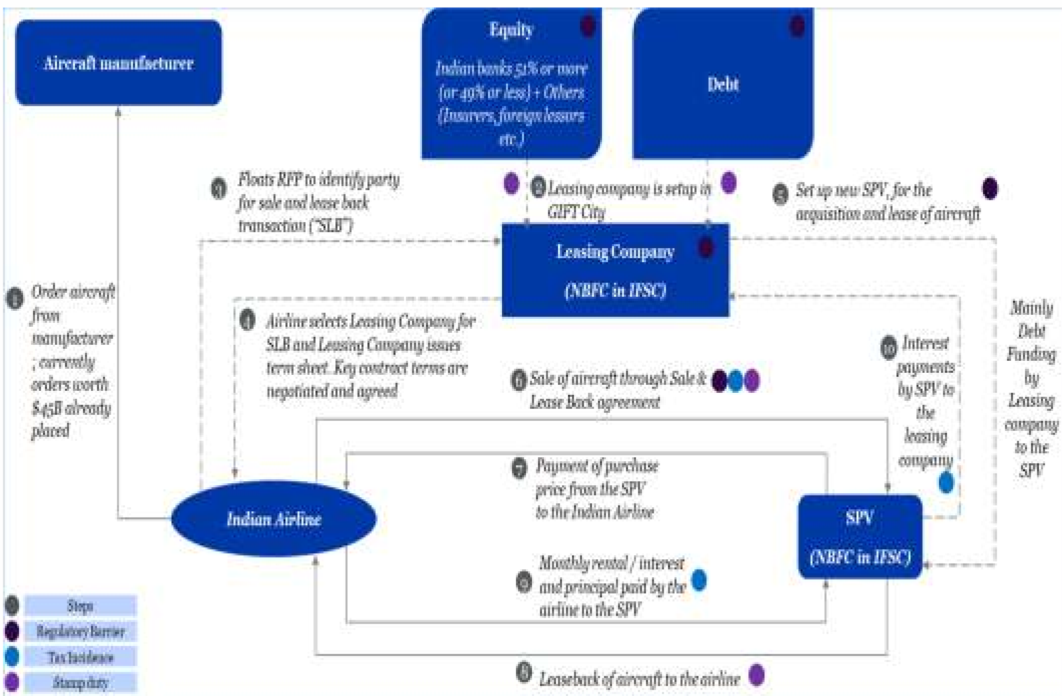
AUTHORITY	CHANGE WRT	PROPOSED CHANGES
Ministry of Finance - CBDT	Income tax	• Outright exemption from interest and related payments paid by a leasing company in an IFSC for period of 5 years followed by a concessional rate of 5% thereafter • MAT to be exempted for aircraft leasing company in an IFSC (insert specific proviso after sub-clause (7) of section 115JB • Amend section 80LA to increase tax holiday for units in IFSC (or specifically aircraft leasing units) to 100% tax deduction for 10 years plus 50% tax deduction for 5 years. • Exempt capital gains tax on sale/ resale of aircraft by a leasing company in an IFSC (section 47 or section 10) or • Concessional capital gains tax of 10% (even for short term capital gains (STCG) since transfer of depreciable asset is always taxed as STCG) • Amend section 47(viiab) to extend capital gains exemption available to non-residents in respect of transfer of bonds, derivatives in a stock exchange in an IFSC, to a resident investor in a leasing company
Ministry of Commerce	SEZ laws	• Dispense requirement of aircraft being physically required to enter the SEZ area (and stay therein); and • Lease rental paid (whether or not in forex) to specifically count toward Net Foreign Exchange (NFE) requirement of IFSC
Ministry of Labor and Employment	Provident Fund	• Amendment to investment guidelines to allow EPFO to invest provident funds into equity or debt of private company or AIFs whether in or outside GIFT City that are engaged in aircraft leasing
Parliament	SARFAESI Act Pension Funds	• Legislative amendment of Section 31(c) to the SARFAESI Act to delete the exception for aircraft. • Legislative amendment to enable pension funds to invest into domestic AIFs, who may use funds for investments into GIFT City SPVs engaged in aircraft leasing
Government of Gujarat	Stamp Duty	• Amendment to the S. 21 of the Gujarat SEZ Act to provide specific exemption from payment of stamp duty on instruments executed in connection with aircraft financing/leasing transactions, such as for: a) Aircraft Purchase Agreement b) Lease of aircraft c) Issue of shares d) Security agreements in connection with aircraft financing transactions
Ministry of Civil Aviation DGCA	Right to detain aircraft	• Government has proposed a draft Cape Town Convention Bill, 2018 which needs to be enacted to ensure full implementation and give overriding effect to CTC
	Online registry for all Indian registered aircraft and engines	• Establish a seamless data connection DGCA's online Register and electronic International Registry. • Establish a similar Register for aircraft engines as there are now increased instances of stand-alone engines being leased by Indian operators

3.4 Indicative Aircraft Financing Structure and Transactional Details Based on Sale-and-Lease-Back (SLB) Arrangement

The Working Group has identified the IFSC in Gujarat International Finance Tec-City (GIFT-CITY) as the preferred destination to nurture this industry in its infancy, due to the regulatory framework it provides to support the industry by offering a competitive tax regime to compete with global leasing giants.

An indicative financing structure in IFSC is set out below along with the current barriers in the transaction:

Proposed Structure In GIFT-CITY IFSC; Bird's Eye View



Barriers envisaged

Steps and related barriers

1. Indian airline places order with manufacturer; 1,000+ airplanes already on order worth over USD 50 billion
2. An Indian Bank along with others (Insurance companies, Pension Funds, Foreign lessors etc.) sets up an Aircraft Financing and Leasing company (an NBFC) in GIFT City. There can be two alternative structures:

   Structure 1: The Indian Banks cumulatively hold 51% or more of the NBFC and others hold the remaining share capital

   Structure 2: The Indian Banks cumulatively hold 49% or less of the NBFC and others hold the remaining share capital

BARRIER	ASK	AUTHORITY
• Aircraft financing not specifically permitted activity for bank/bank subsidiaries • Bank branches/units established in GIFT City not permitted to undertake aircraft financing • No framework for setting up NBFC in GIFT city • Unclear whether income from operating leases will be treated as financial income for NBFC eligibility test • Restrictions on investments by Insurance companies, AIFs, Pension Funds, Mutual Funds	• Issue new notification or clarification to permit **Aircraft Financing** • **Amend circular** governing activities by banks in GIFT City • **Issue Framework** for NBFC to operate in GIFT City • Clarification required that entity earning only operating lease rental income is eligible for NBFC license • Exempt insurers from the restriction on investment in private companies, overseas investments • Remove restrictions on AIFs	• RBI & MoF • RBI • RBI • IRDAI • PFRDA • SEBI

3. Indian airline floats an RFP to identify leasing companies (bank/ bank subsidiaries) to enter in a "SLB" arrangement.
4. Airline selects Leasing Company in IFSC GIFT for SLB transaction and Leasing Company issues term sheet. Key contract terms are agreed. The lease from Leasing Company to airline could be an Operating Lease or a Finance Lease.
5. Leasing Company will set up a SPV, for the acquisition and lease of aircraft. Leasing Company will fund the SPV mainly through debt. It is customary to set up a new bankruptcy remote SPV for funding of each aircraft.

BARRIER	ASK	AUTHORITY
See Step 2	• Additionally, allow bank branches/units to **establish SPV** for Aircraft Financing • Additionally, allow NBFCs to **invest in SPV** for Aircraft Financing	RBI

6. The SPV will enter in a Sale and Lease Back arrangement with Indian airline.

BARRIER	ASK	AUTHORITY
• GST of 5% incurred on import of aircraft by the Leasing Company • Stamp duty applicable on various instruments/ documents for the transaction any in GIFT City	• BCD & GST on import to be made "Nil" for leasing company • Amend the Gujarat SEZ to provide exemptions from payment of Stamp duty	• CBIC – GST Council • Govt. of Gujarat

7. The SPV will pay the airline the price for the airplane agreed between the airline and the Leasing Company. This price may be higher than the price agreed between the airline and the manufacturer, resulting in a profit for the airline.
8. Airline will lease the airplane back from the SPV under an Operating Lease or a Finance Lease.

BARRIER	ASK	AUTHORITY
Stamp duty applicable on various instruments/ documents for the transaction	**Amend the Gujarat SEZ Act** to provide complete exemption from payment of Stamp duty	Govt. of Gujarat, RBI and MoF

9. Airline will pay a monthly rental to the SPV in case of an Operating Lease, and interest + principal payment in case of a Finance Lease.

BARRIER	ASK	AUTHORITY
5% GST will apply on the lease rentals	**"Nil" rate of GST** on leasing of aircraft by domestic leasing company	CBIC – GST Council

10. Principal and Interest paid by SPV to the leasing company.

BARRIER	ASK	AUTHORITY
Interest paid by leasing SPV in IFSC not eligible for any beneficial regime and taxable at full rate for domestic lender	Outright exemption from interest and related payments paid by a leasing company in an IFSC	MoF – CBDT

3.5 Financial Model on Rupee Financing and Leasing

The Working Group has identified systemic inefficiencies and options to make domestic financing and leasing attractive to airlines, financiers, insurers, credit guarantors, and lessors/ asset managers located in India, based on which financial viability was found.

The key assumptions of this financial model are as below:

PARTICULARS	KEY ASSUMPTIONS
Estimated purchase price (PP)	$50M
Useful life of aircraft	25 years
Lease term: First lease Subsequent leases	12 years 13 years
Pre delivery payment (assumed 40% of cost)	$20M
Annual lease rentals: First Lease (lease rate factor: 0.85%) Subsequent leases	$5.10M per annum $1.92M per annum
Debt : Equity	80 : 20
Expected return on equity	7.50%
Cost of Funding: $ denominated (80%/IFSC; 100%/Ireland)	4.50%
Rupee denominated (20% for IFSC)	10%
Currency hedging cost	5%
Operating expenses including lease management expenses	$0.75M per annum
MRO charges	$4M p.a. for first 12 years; $5M p.a. subsequent years
Depreciation Allowance (For accounting – 25 years)	For tax – 12.5% SLM (Ireland); 40% WDV (GIFT, India)
Sale value of aircraft at end of 12 years	$7.50M

3.5.1 Comparison of Transacting Out of Off-shore IFSC in India and Major Global Jurisdictions

PARTICULARS	IRELAND	IFSC_INDIA	SINGAPORE	HONG KONG	CHINA
Corporate Tax Rate	12.5% (However group consolidation allowed)	• Exemption available – 100% (First 5 years) and 50% (next 5 years) (However no group consolidation allowed) • 34.96%	17% (reduced to 8% for income derived from aircraft leasing activities)	16.5% (reduced to 8.25% for qualifying aircraft leasing and leasing management companies)	25%
Minimum alternate tax for Lessor Company	Not applicable	Book profits subject to tax at 10.48%	Not applicable	Not applicable	Not applicable
Tax depreciation allowance	Allowed to depreciate the aircraft cost over 8 years.	Allowed to depreciate the aircraft for MAT computation over 20 years	Can depreciate the aircraft over any number of years from 3 to 20 years	Not applicable	10 years
Interest expense on aircraft loan/ intercompany funding	Deductible on arms' length payments	Deductible on arms' length payments	Deductible on arms' length payments	Deductible subject to fulfillment of certain conditions	Deductible on arms' length payments
WHT on interest payment by lessor SPV	20% (exemption available to payments to 'Qualifying lender') Typically would be 'zero' WHT	Interest to domestic parties – 10% Interest to non-residents – Typically 10/15%% in tax treaties	Nil	Not applicable	10% (Maybe reduced by applicable DTA)
WHT - lease rental paid to lessor	Nil	2%	10%	10%	10%
GST on lease rental payments by Indian Airlines	5%	5%	5%	5%	5%
Taxable base	Gross rentals less deductible expenses including depreciation allowance No taxability since significant tax depreciation allowance available	Gross rentals less deductible expenses including depreciation allowance No taxability under normal tax computation, however taxable on the book profits under MAT	Gross rentals less deductible expenses including depreciation allowance	20% (Gross lease rentals less allowable expenses excluding depreciation) Effective tax rate ~ 3%-4%	Gross rentals less deductible expenses including depreciation allowance
Disposal of aircraft	Taxable as business income to the extent of the original cost and excess gains taxable as capital gains	BBeing a depreciable asset, capital gains will be subject to 34.99% (approx.)	Nil	Not subject to tax on aircraft disposal after three years	Capital gains is taxed as part of operating income at 25%
Stamp Duty	Nil	Applicable	Nil	Nil	0.1% to 0.005% depending on nature of lease arrangement

3.5.2 Overview of Tax and Duties: Proposed Regime in IFSC

PARTICULARS		IRELAND	IFSC_GIFT City	INDIA
INCOME-TAX				
Corporate tax rate	Year 1 to 5	12.50%	0.00%	34.94%
	Year 6 to 10		17.47%	
	From year 11		34.94%	
Minimum Alternate Tax	MAT	0.00%	10.48%	21.55%
Capital gains tax on sale of aircraft	CGT	33.00%	0.00%	34.94%
WHT on operating lease rentals	WHT	0.00%	0.00%	2.00%
WHT on interest payments (USD debt)	WHT	0.00%	0.00%	5.46%
WHT on interest payments (INR debt)	WHT	NA	0.00%*	0.00%*
WHT on other payments (Lease mgmt., MRO)	WHT	0.00%	0.00%	10.00%
Dividend distribution tax	DDT	0.00%	Nil	20.56%
GOODS AND SERVICES TAX				
GST on purchase of aircraft	GST	0.00%	0.00%	0.00%
GGST on operating lease rentals	GST	5.00%	0.00%	5.00%
GST under finance lease (interest portion)	GST	5.00%	0.00%	5.00%
GST on other services	GST	0.00%	Nil	18.00%
Stamp duty on lease related documents	As provided	0.00%	0.00%	3.00%

3.5.3 Overview of Tax and Duties: Implications of Current versus Proposed

Amounts in USD Million

	Current Regime			Proposed Regime		
Particulars	Ireland	GIFT City	India	Ireland	GIFT City	India
Scenario 1 – Aircraft is sold at the end of Year-12						
Income-tax costs (including WHT)	-	$ 5.27 M	$ 8.24 M	-	$ 0.65 M	$ 8.24 M
GST (operating lease rentals)	$ 3.06 M	$ 3.06 M	$ 3.06 M	$ 3.06 M	-	$ 3.06 M
Stamp Duty (lease agreement)	-	$ 0. 25 M	$ 0.23 M	-	-	$ 0.23 M
Total tax costs	$ 3.06 M	$ 8.58 M	$ 11.52 M	$ 3.06 M	$ 0.6 5 M	$ 11.52 M
Scenario 2 – Aircraft is fully used for 25 years						
Income-tax costs (incl. WHT)	-	$ 3.99 M	$ 7.54 M	-	$ 1.44 M	$ 7.54 M
GST (operating lease rentals)	$ 4.31 M	$ 4.31 M	$ 4.31 M	$ 4.31 M	-	$ 4.31 M
Stamp Duty (lease agreement)	-	$ 0.14 M	-	-	-	-
Total tax costs	$ 4.31 M	$ 8.45 M	$ 11.85 M	$ 4.31 M	$ 1.44 M	$ 11.85 M

DETAILED ANALYSIS AND ROADMAP FOR DEVELOPING AIRCRAFT FINANCING AND LEASING IN INDIA

4.1 Introduction

Aircraft leasing industry is a significant industry in the world today. The share of aircraft on lease has increased drastically over the last few decades from 2 per cent in 1980 to over 41 per cent in 2018 as per a study[1]. Between 2001 and 2017 alone, the change has been more than 25 per cent. In future, the market size is estimated to increase to USD 62 billion by 2023 recording a compound annual growth rate (CAGR) of 4.7% from 2017 to 2023. From around 41 per cent of aircraft on lease in 2018, leased out aircraft deliveries are projected to rise to 50 per cent by 2021. Financing requirement has also been rising and has registered an increase of 100 per cent over the past 7-8 years. Lessors are gaining from the secondary market purchases of the aircraft. The capital market, on the other hand, continues to grow with improved and innovative financing options, particularly in Asian markets. Availability of cheap debt financing and bank funding in Middle-East and Asia have also helped in creating a robust leasing industry.

Sources of industry delivery financing

Historical share of funding by capital provider

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019F
Cash	26%	25%	26%	25%	24%	23%	28%	26%	27%	26%
Capital Markets	14%	15%	18%	19%	28%	34%	30%	24%	28%	30%
Bank Debt	26%	27%	23%	30%	33%	30%	33%	44%	39%	34%
Export Credit	34%	33%	33%	26%	15%	13%	8%	4%	4%	7%
Insurance								1%	2%	3%
Manufacturer	0%	0%	0%	0%	0%	0%	1%	1%	0%	0%
Total Revenue USD billions	$62	$77	$96	$104	$115	$122	$122	$122	$126	$143

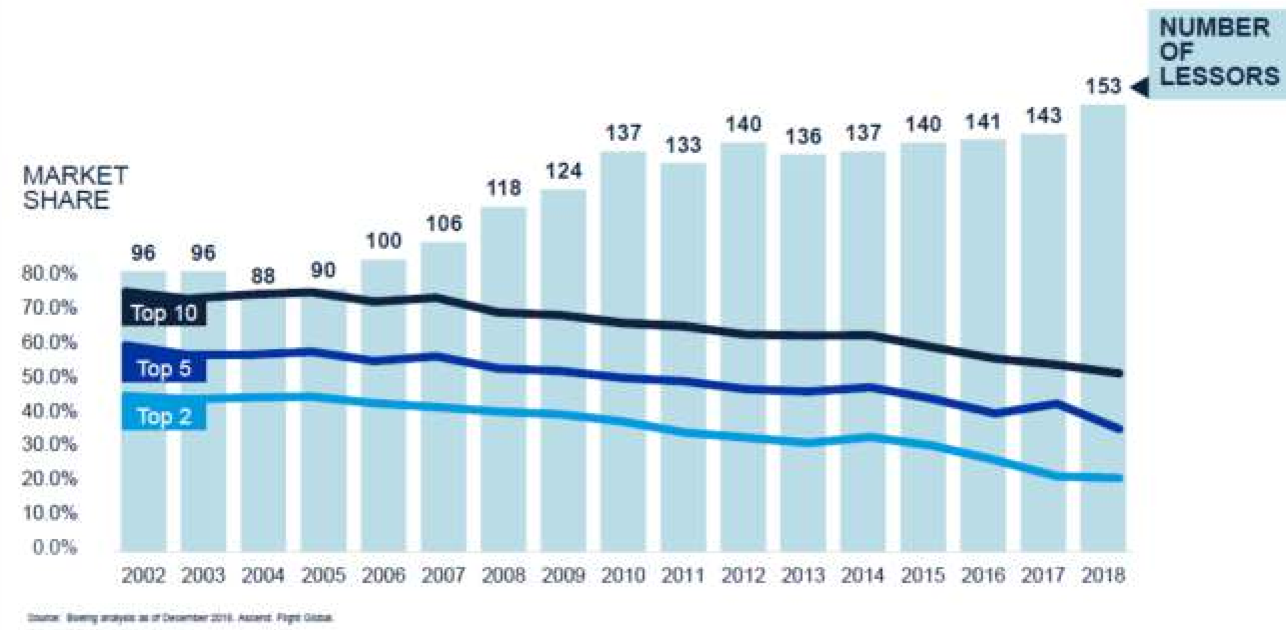
Commercial Deliveries	2010	2011	2012	2013	2014	2015	2016	2017
Boeing	462	477	601	648	723	762	748	763
Airbus	510	534	588	626	629	635	688	718
Bombardier*	97	78	50	55	86	76	84	17**
Embraer	101	105	106	90	92	101	108	101

- Bombardier deliveries for 2009-2011 are for the respective fiscal years
- ** C Series deliveries .

Historical numbers subject to revision.

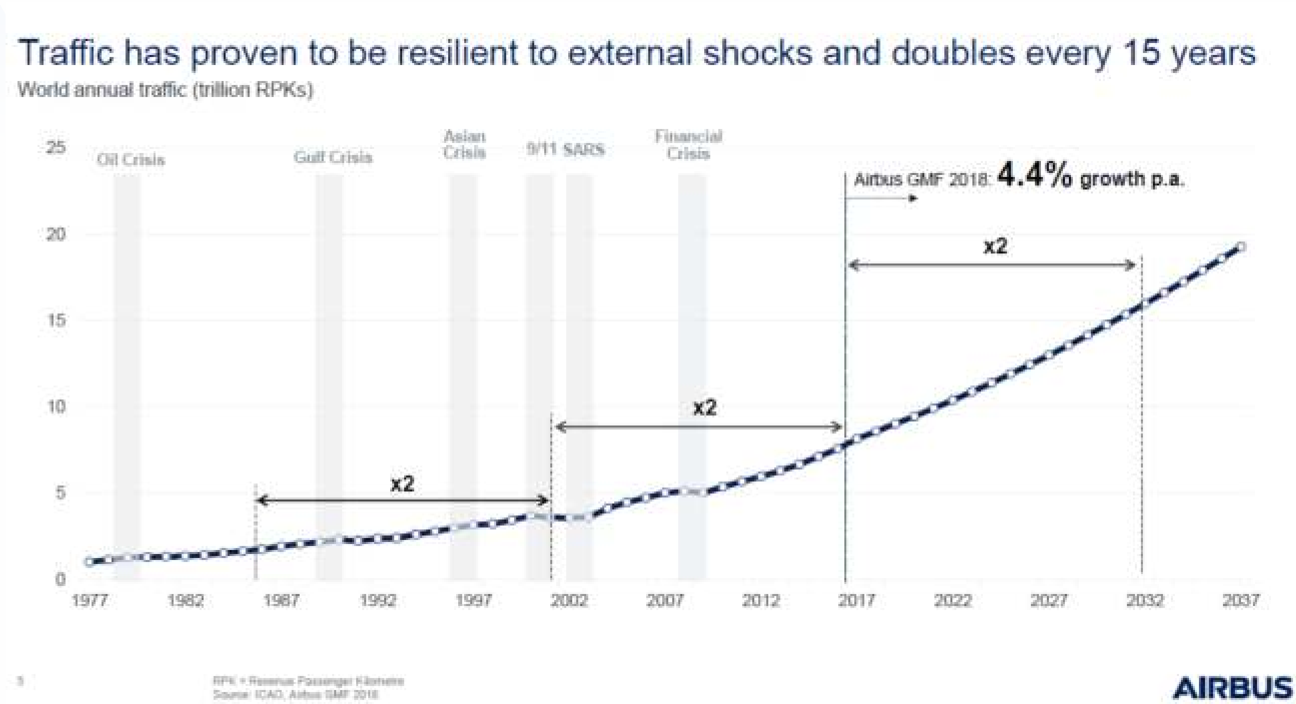
[1]Global Aircraft Leasing Market Research Report – Forecast to 2023: Market Research Future, December 2017.

These sustained trends clearly highlight the rate at which the aircraft leasing business is growing across the globe and make the potential of aircraft leasing industry worth exploring for India too. An upsurge in air passengers and freight traffic in India underpinned by the growth in the middle-class income, better regional air connectivity and infrastructure, and globalization in emerging economies are expected to support a growing commercial aviation industry around the world, in light of which, many studies have stipulated a large increase in demand for new aircraft and financing.

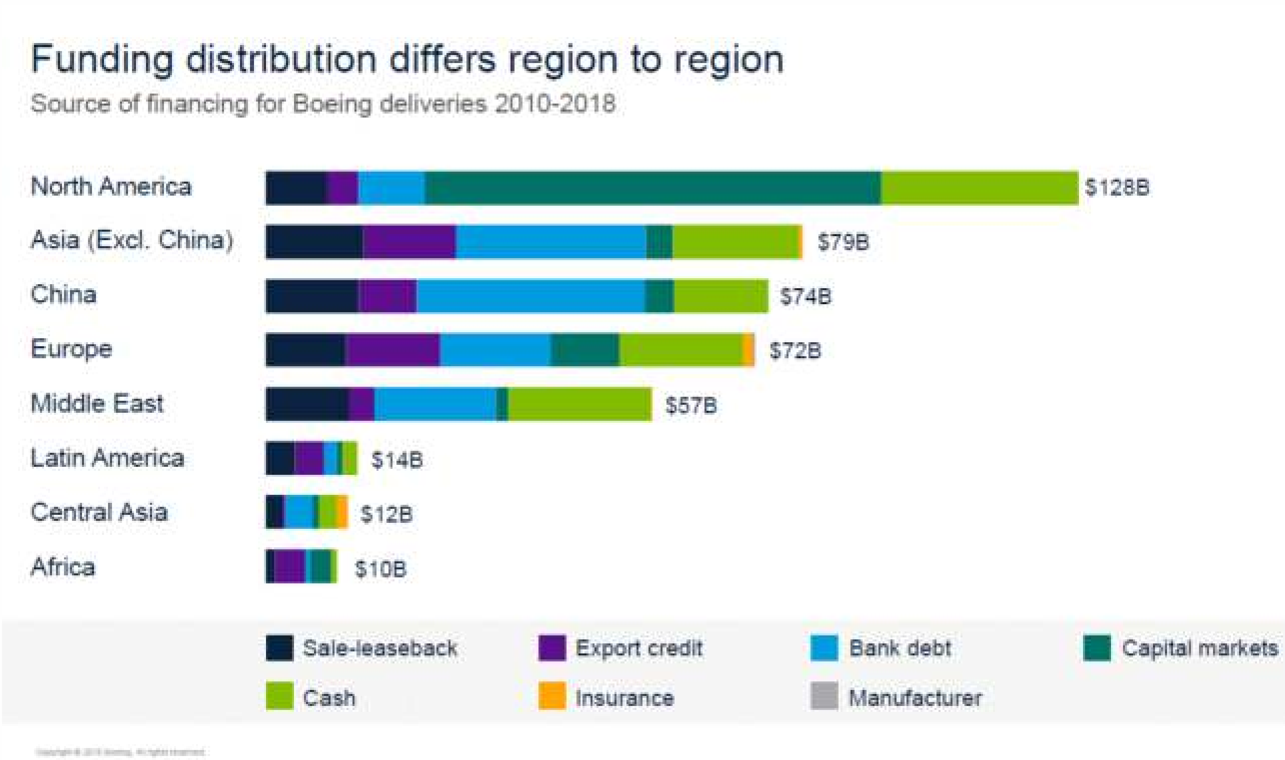


Aviation industry-wide, the International Air Transport Association (IATA) has forecast that overall aviation industry revenues will reach USD 885 billion, growing by 7.7% on USD 821 billion realised in 2018. Total employment by airlines is expected to reach 2.9 million in 2019, growing by 2.2% on 2018. Wages are also rising, reflecting the tightness of labour markets, and it has been forecast that unit labour costs would increase by 2.1% in 2019 after a long period of stability. Aviation jobs are getting more productive, and productivity has been assessed to increase in 2019 by 2.9% to 535,000 available tonne kilometres/ employee. Passenger traffic (revenue passenger kilometres-RPKs) is expected to grow by 6% in 2019 from 4.34 billion in 2018, which will outpace the forecast capacity (Available Seat Kilometers-ASKs) increase of 5.8% and remains above the 20-year trend growth rate. This in turn will increase load factors and support a 1.4% increase in yields (partially clawing back the 0.9% fall experienced in 2018). Passenger revenues, excluding ancillaries, are expected to reach USD 606 billion, up from USD 564 billion in 2018. Within the next two decades, as per Boeing's estimates, global RPKs are set to triple from 2015 to reach 17 trillion RPKs by 2035.

As far as air cargo is concerned, which improves the revenues of airlines in a significant way, growth is slowing somewhat on account of increasing protectionism in world trade. Thus the 3.7% annual increase in cargo volumes from 63.7 million tonnes in 2018 to 65.9 million tonnes in 2019 predicted by IATA would be the slowest pace since 2016. Cargo yields are expected to grow by 2.0%. This would be well below the exceptional 10% yield growth in 2018. Air cargo will, however, continue the recent strengthening of the cargo business, since cost increases are lower. Overall cargo revenues are expected to reach USD 116.1 billion, up from USD 109.8 billion in 2018.



Asia-Pacific region has experienced an exponential growth in air passenger traffic in the last decade. India along with China and other Asian emerging economies have been going through a significant surge in air travel demand. Asia-Pacific carriers are forecast to report a USD 10.4 billion net profit in 2019, up from USD 9.6 billion in 2018, though carriers in North America would continue to lead on financial performance accounting for nearly half of the industry's total profits. The expected net profit per passenger is likely to be USD 6.15. This is a region of diverse markets, some of which are seeing strong growth from new LCC entrants while others are highly dependent on outbound cargo from key manufacturing centres. Cargo revenue growth has slowed from the strong performance of 2017 but remains positive for airlines in the region. Lower fuel costs, low levels of fuel hedging and strong regional economic growth are supporting profitability in 2019 in this region.



Consistent with the growth in the last decade of the Asia-Pacific region and its high growth potential continuing over the next couple of decades, over the past few years it has been observed that the geography of the operations for aircraft leasing industry has been moving fast from Western nations to Eastern nations due to presence of a strong and a stable financial market and active involvements of State. Today five out of the twelve biggest lessors belong to Asia. They have grown in size because of frequent acquisitions, collaborations and partnerships, China being the most prominent example of such development. The synergies from inorganic growth have been pivotal in the dramatic growth of aircraft leasing companies in China.

India has been slow to start in this segment of aviation industry and must soon explore and derive strategies to develop a robust aircraft leasing industry in the country. Having experienced a surge in aircraft demand, most of the Indian airlines are meeting this demand through offshore aircraft lessors and paying them in dollars.

4.2 Case for an Aircraft Financing and Leasing Industry in India

The cost of purchasing an aircraft is high and curtails the fleet expansion plan of the carriers, newer ones in particular. In such a scenario it is economical for carriers, especially the low cost carriers (LCC) to lease aircraft as the cost gets spread across the lease period making it possible for the operator or carrier to fly at competitive rates. Leasing is an efficient means to fulfill short-term capacity requirements without burdening the balance sheet of the airlines. Indigo, one of the largest operators in Asia and a LCC owns only a fraction of its fleet of 200 aircraft at the end of 2018. The carrier runs on sale and lease-back model. Under this model the operator purchases the aircraft from manufacturers (as manufactures sell their aircraft at a lower price to operators than to leasing companies) who then sells it to a lessor and later leases it back from the lessor. With such leasing model the operator successfully gets to operate younger flights with low maintenance cost and also benefits from the leasing back of aircraft. As per a recent report, total lease rental payment by Indigo in FY18 was around INR 36 billion and is expected to rise to almost INR 75 billion (more than a billion dollars) in 2020-21. This shows that aircraft leasing industry is a huge industry and Indian carriers are incurring large dollar-denominated expenses. As a result, any depreciation of the Indian Rupee against the US Dollar will amount to a large cut in net profits for the Indian carriers.

India is much behind other Asian economies such as China, Singapore and Hong Kong which are fast emerging as new leaders in global aircraft leasing market. The key players of the market hail from Ireland and the US and they are facing tough competition from emerging aircraft leasing firms based in China, Hong Kong, Japan and Singapore. The Asian firms have managed to get into the top players list globally through extensive and appropriate State support, access to diverse sources of capital and a robust acquisition strategy. Indian aviation industry underpinned by rising passenger traffic flow and economic prosperity holds immense potential for the development of aircraft leasing Industry which in turn is capable of attracting investment and creating jobs. The industry ignored for long in India needs conducive investment ecosystem with a balance between private and public entities before other emerging economies take over the global market. But the lack of favorable investment climate would make it extremely difficult for the country to catch up.

There has been unprecedented growth of the Indian aviation sector over the past decade with exponential acceleration in the last five years. As per the Directorate General of Civil Aviation (DGCA), domestic and international passenger traffic has witnessed a positive annual growth rate of 18.86% and 10.79% respectively in 2017-18 and a growth of 16.08% in overall passenger traffic. The domestic passenger traffic is reported to have risen at a compounded annual growth rate of 10.76% during the period 2007-08 and 2017-18 and international passenger traffic grew at 8.32% (CAGR) during the same period. Total passenger traffic to, from and within India, during April to November 2018 grew by around 15% year on year as compared to around 6% globally. India is now the seventh largest aviation market with over 200 million passengers in achieved in 2018, and is expected to become the third largest by 2022. If the trend continues, India would become one of the top aviation hubs by 2040. The passenger traffic is expected to grow six-fold to around 1.1 billion.

From 74 operational airports in 2013, in the last five years the number has grown dramatically to 101 at the close of December 2016. India is projected by industry studies to have around 190-200 operational airports in 2040. By then, about top 31 cities may have two airports each, with Delhi and Mumbai having three each. The incremental land requirement associated with this is expected to be around 150,000 acres and the capital investment (excluding the cost of acquiring land) is expected to be around USD 40-50 billion. The Working Group took into account the status of the India's Air Transport Sector and the projections that have been outlined in the August 2018 report of AITA (Annex: VII) and of CAPA - India on the country profile presented in its November 2018 report (Annex: VIII).

India has one of the largest aircraft order books currently with pending deliveries of over 1,000[2] aircraft for its scheduled airline operators alone. A FICCI-Yes Bank study of March 2018 has projected that the commercial airline fleet is likely to grow from around 620 in March 2018 to around 2,350 in March 2040. The aviation industry in India, as per the European aircraft manufacturer Airbus, would need around 1,750 aircraft in the next 20 years, while Boeing has placed the need at over 2,100 aircraft. As per another study done by Centre for Asia Pacific Aviation (CAPA), the number of aircraft operating in India would exceed the 5,000 mark by 2050. Against the global average of 41% share of aircraft operated on lease, Indian carriers are operating with over 70% of the fleet procured on lease basis. In addition, the general aviation fleet of aircraft of about 750 at the close of year 2018 has been projected by industry to rise to 6,100 aircraft by 2040.

Virtually all of the commercial aircraft are leased through leasing companies located offshore. The aircraft order book of 1,000 aircraft which are thus also likely to be leased through offshore lessors at an estimated fair market value of more than USD 50 billion, which is estimated to generate an annual lease revenue of USD 5 billion and annual tax revenue of USD 200 million. Aircraft leasing industry which would provide supporting services to the aviation industry has a crucial role to play in the growth of this sector and therefore, will make a significant contribution to the respective economy of the offshore leasing hubs.

Under the Regional Connectivity Scheme *Ude Desh ka Aam Naagrik* (RCS-UDAN) launched in 2016, the Government of India envisions to expand the remote area connectivity, and since its launch has been able to extend the aviation network to cover 35 underserved and unserved cities so far by making air travel accessible and affordable to the masses. The NABh Nirman (Next-Gen Bharat) programme is also underway with over Rs 1 lakh crore in committed investments. As a part of the same initiative, Government has decided to lease out the operations, maintenance and development of 6 airports (Ahmedabad, Jaipur, Lucknow, Guwahati, Thiruvananthapuram and Mangaluru) under PPP. Indian airports have achieved global acclaim being rated at the very top on service-delivery standards in their respective size category. Apart from further improving service delivery, the increased revenues for the Airports Authority of India which owns and controls the vast majority of Indian airports country-wide will lead to further investment in airports of Tier II and Tier III cities and economic development in these areas. These and other trends, covering digitization, automation, security, safety, and ease of doing business, have been and will continue to have positive consequences on the air passenger traffic, air cargo handled, and aircraft demand in the country.

Building a robust aircraft leasing industry[3] supported by domestic institutions and foreign lessors would enable setting up this growing business activity in India, as India should not only rely on the offshore lessors to lease the upcoming airline fleets as this would imply large currency outflow and forgone potential tax revenue. Air transportation growth, both passenger and cargo, in size, indisputably, lays emphasis on the growing demand for aircraft and clearly signals at the prominence of aircraft leasing companies in the near future. The growth in aircraft leasing industry would also percolate to financial and job markets and create many significant economic and social benefits and job opportunities in all sectors of the aviation industry, including the associated sectors.

[2]For details on the aircraft fleet in India, see CAPA – India, Aircraft Fleet and Finance Report, August 2018 (Annex: IX).

[3]For details on the growth and development of the overall Indian leasing industry, and notably the classification of lease products, accounting standards, and regulatory provisions and issues, see "India Leasing Report-2016 with subsequent editions, produced by M/s. Vinod Kothari Consultants Pvt. Ltd.

4.3 Aircraft Financing Soaring in China – Learnings for India

After the China Banking Regulatory Commission (CBRC) relaxed the regulations on aircraft leasing in 2007, many financial institutions led by China's big banks started building up their aircraft-leasing arms and developing their own capabilities and scale in this segment. Given the importance and high profits of financing and leasing in the aviation sector, and the direct, indirect and catalytic impacts on its overall economy, tax revenues and jobs, China in late 2013 began to participate and invest in the global aircraft financial leasing to support the high upcoming demand for the airplanes in China and across the world, including India. In a study conducted by Boeing in 2017, Chinese airlines' demand for airplanes is likely to increase to 7,240 valued at more than USD 800 billion by 2037. This was around 40 per cent of the total deliveries forecasted for Asia pacific region.

Government of China quickly adopted policy measures to accelerate the development path of aircraft leasing industry by supporting financial leasing industry. It identified the major barriers and adopted lessor-friendly policies to quickly strengthen and augment the growth of leasing industry and persuaded OEM manufacturers of aircraft and critical aircraft parts to establish both manufacturing and MRO capacity in China. Backed with a strong financial sector, China amended the regulations on financial leasing companies for better liquidity, and it further lowered the entrance threshold of financial leasing companies. The Chinese Ministry of Finance, State Administration of Taxation and other government organizations together published documents to promote aircraft leasing sector. Together they envisaged to break down barriers in financing, leasing, taxation and customs. As a result of such actions by the State, within a period of not more than 2 years, 600 leasing enterprises of various nature were registered in Shanghai Free Trade Zone (FTZ). The rest is history – Chinese financiers are increasingly entering into aircraft finance market in Asia-Pacific and the rest of the world. China has also very well leveraged the strength of Hong Kong as a center for aviation leasing.

Aircraft leasing industry in China has come a long way over the past decade. In 2007 the share of China in global leasing industry was negligible, but by end of 2017 it owned 1 in at least 10 leased airplanes worldwide as per the Chinese government report. Chinese aircraft lessors also own around 50 per cent of a total of 1369 leased planes in China. The total number of major leasing companies increased from 4 in 2007 to more than 20 in 2017. The status of major Chinese leasing companies in 2017 among the Top-10 global lessors is highlighted below:

- **USD 280 billion Portfolio of Top-50 Lessors**
- **USD 167 billion Total Fleet Value of Top-10 Lessors**

1. AerCap (The Netherlands) – USD 32 billion – [Transacts an aircraft a day]
2. GECAS (Irish-American) – USD 26 billion
3. **Avolon (Ireland-Bohai Capital) – USD 19 billion**
4. SMBC Aviation Capital (Ireland-Sumitomo Mitsui) – USD 16 billion
5. BBAM Llc (USA-Australia) – USD 15 billion
6. **ICBC Leasing (China) – USD 14 billion**

7. **BOC Aviation (Singapore) – USD 14 billion**
8. Air Lease (USA) – USD 13 billion
9. **DAE Capital (Dubai – merged since then with Avolon) – USD 10 billion**
10. Aviation Capital (USA) – USD 7 billion

- **USD 11 billion Regional Jet Leased Fleet**

With the support of government authorities and government owned lessors and lessees, China has been successful in developing a viable and competitive aircraft leasing market. Major local players are the leasing subsidiaries of the big banks owned by the Chinese Government. The local players have been able to meet China's demand for aircraft and have also marked their presence in the international market. Similarly, Hong Kong and Singapore have also become the investment choices for international aircraft lessors because of low headline tax rates and double tax avoidance agreements. Hong Kong through investor-friendly changes in its taxation regime has become a favorable lessor destination. Similarly, Singapore has also established itself as an international financial, trading and transportation centre through a favorable tax regime and investor-friendly policy measures. These countries are giving a tough time to the leading Western counties with established aircraft leasing industry such as Ireland, The Netherlands and the US.

4.4 India: Setting up of the Working Group

Recognising the aviation sector imperatives, this Working Group was constituted by M/o Civil Aviation under the chairpersonship of the Economic Advisor in the Ministry to kick-start the process of development of domestic aircraft financing and leasing industry. The terms of reference are set out in the Order constituting it (attached herein in **Annexes-I and II**). Its membership comprised of the relevant governmental ministries and regulatory authorities, apart from field expert representation from airlines, aircraft manufacturers, corporate industry, legal and aviation capital consultants, leasing and financial sector experts and academicians.

This Report thus covers the rationale for India to have a reasonably well-developed domestic aircraft financing market and the regulatory changes that may be necessary to accomplish the task before it. The Group examined the challenges underpinning the low participation in aircraft financing by domestic Indian financiers; it has made suggestions to overcome them; and having taken a 360-degree view of the current legal and regulatory environment affecting aircraft financing and leasing in India, it has laid down its observations and recommendations for changes therein. It is highlighted that while the analysis in detail is set out in sub-section 5.7 below, the Working Group has developed Draft Texts for the proposed legal and regulatory interventions in order to facilitate their speedy consideration and disposal by the competent authorities.

The 360-degree review has thus encompassed identification of challenges and barriers, identification of potential solutions, identification of systemic inefficiencies in domestic financing and leasing, identification and assessment of options to make domestic financing and leasing attractive to airlines, financiers and lessors/ asset managers located in India.

The Group held over 30 meetings, formal as well as of a brainstorming nature, with various stakeholders, besides weekly conference calls amongst the small functional group constituted for reaching out to the stakeholders and conducting detailed research and examination of the issues identified in consultation with the stakeholders. The Group thus met domestic and foreign airlines, banks, insurers, pension funds, NBFCs, AIFs, foreign lessors/ asset managers, Central Government Departments (Revenue, Economic Affairs, Financial Services, Corporate Affairs, Commerce, Industry), and regulators (IRDAI, PFRDA, RBI, DGCA). M/s. Trilegal and M/s. PricewaterhouseCooper provided yeomen services through research and comments.

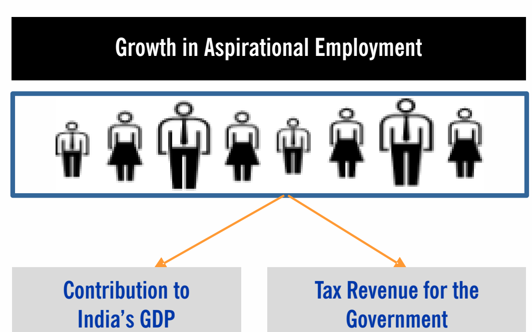
Significantly, the Group has developed the potential financing structure, which has been given in the Section on Principal Recommendations in Summary and supplemented in the Annexes herein. These were shared with stakeholders for their factoring in the requirements of the setting up of aviation finance ecosystem and its use of the Indian industry and financing fraternity. The Group also developed tentative timelines for implementation of the regulatory changes, which however, are not reproduced herein, but have been shared with all governmental and regulatory bodies and industry stakeholders during formal meetings held by the Working Group.

The Working Group also held meetings with interested stakeholders (banks, insurers, credit guarantors, lessors, airlines, etc.) to encourage the initiation of transactions between them.

It is emphasised that while the Working Group has tried to identify all the challenges and barriers to participation by domestic and international financiers, and other entities in aircraft financing and leasing, the recommendations focus on the regulatory changes required in Government of India's IFSC regulations, keeping in mind the role of the IFSC being that of an offshore financial centre.

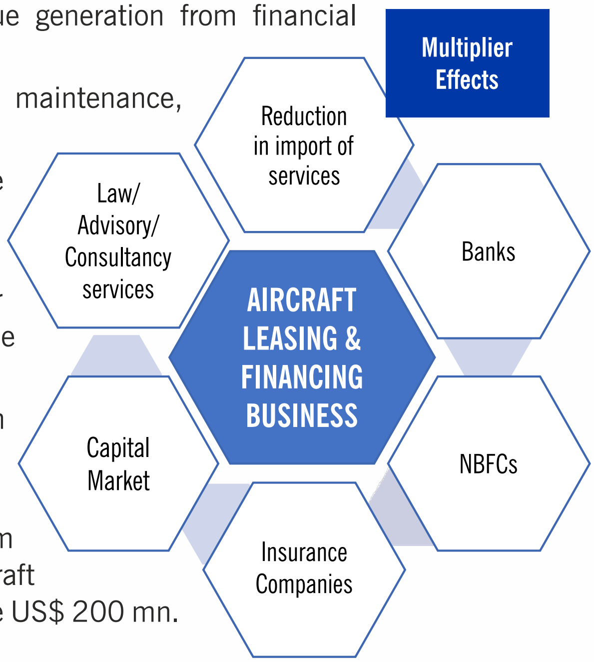
4.5 Importance of a Well-Developed Domestic Aircraft Financing Industry

Having a well-developed aircraft financing and leasing market is a *sine qua non* for the development of a self-reliant aviation industry, which in turn is essential for India's growth. Additionally, there are several factors that have led to the current focus of the Government of India on aircraft financing and leasing industry:



- The civil aviation sector is strategically important for the country. Aircraft are fulcrum of civil aviation – but, aircraft financing and related job-creation is a glaring vacuum in India.
- Aircraft financing is the most profitable segment of the aviation value chain. Currently, foreign financiers and lessors are the biggest beneficiaries of India's growing pie.

- It is vital to develop this new line of business in India for financial services and add India on the map of global financial centres for international financial services.
- It will also foster greater participation for Indian insurers/ credit guarantors (more domestic financiers may mean more business being available to domestic insurers and credit guarantors, as against foreign insurers).
- Key for developing a market for Indian RTA, and a boost for Make-in-India.
- It provides an impetus for development of Indian MRO industry, as currently, Indian MRO is also stymied due to financier/ lessor preferences for overseas MROs as a part of the financing/ lease transaction.
- Creating additional high-end jobs' opportunities in India not only directly through aircraft financing, but also ancillary jobs in industries such legal, accounting, etc.
- Preserving and retaining the sources of revenue generation from financial services.
- Reducing foreign exchange outgo (lease rentals, maintenance, legal/consultancy fee etc.)
- Creating a reliable, new source of financing for the domestic airlines. Commercially significant for airlines.
- Harnessing an additional source of revenue for domestic financiers. The annual lease revenue opportunity is estimated at US$ 5B[4].
- Profitable avenue for infrastructure finance in India.
- Generating additional sources of governmental revenues through collection of taxes/ duties from ancillary industries, and eventually through aircraft financing and leasing, which alone could be above US$ 200 mn. annually[5].
- Bringing various foreign lessors in India.



In conclusion, lessors are a vital part of the aviation industry. Aviation finance is highly competitive and innovative customized solutions are the new norm. Bank debt is geographically balanced with unprecedented volumes, the secondary market (of about USD 870 billion, including an estimated USD 43 billion for meeting the refinancing requirements of lessors and other aviation stakeholders) represents attractive financing opportunity, and capital markets are providing inexpensive secured and unsecured liquidity for lessors, who gobbled up 70% of the amount totaling USD 21 billion in 2018 and left the balance 30% for airlines. The time is ripe is opportune to swiftly seize the opportunities in IFSCs, such as Gujarat International Finance Tec-City (GIFT City), for developing aircraft financing and leasing services. The project which merits implementation in mission mode has been named “Project Rupee Raftaar”.

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[4]Assumes 12% lease yield (Lease rent divided by FMV of asset) per Airfinance Journal article dated 01.05.2018 for US$ 50B asset value.
[5]Assumes 10% ROE and 3.0x leverage for US$ 50B asset value; 20% tax rate.

4.6 Current Challenges and Barriers to Domestic Aircraft Financing Industry

In a nutshell, the current legal and regulatory frameworks are not conducive to aircraft financing. Direct and indirect taxes make it cost prohibitive as compared to other jurisdictions (e.g. Ireland), for instance through the following:

- High rate of direct taxes; non-exemption from withholding taxes
- GST on multiple points of transaction; lack of clarity about applicability of GST on transactions by financiers/ lessors versus airlines
- Stamp duty
- General Anti-Avoidance Rules (GAAR) prevent Indian financiers from taking advantage of other jurisdictions

There is inadequate appreciation of aircraft financing by Indian financiers, while the potential from Banks, Non-Banks, FIs, AIFs, HNI, pension, insurance and provident funds remains untapped despite aviation financing have proven itself to be the more profitable segment of the aviation chain bringing to its investors returns on equity investments ranging upwards of 10-15% even during the global financial crisis period, notwithstanding the competing investment opportunities historically for domestic financiers. High funding cost for Indian financiers has also been a deterrent due to factors such as credit risk, India jurisdiction risk and requirements of currency hedging.

The challenges and barriers that have been identified and the prospects for an Indian Aircraft Leasing sector assessed by CAPA India in its September 2018 report (Annex: X) had been discussed in detailed with the stakeholders by the Working Group. The case for creating an enabling environment for Aircraft Financing and Leasing industry in India has been made out by the Working Group in its recommendations after taking into account challenges, barriers and other limitations outlined in the report by CAPA India.

The examination of the barriers and challenges brought out comprehensively the need for India to enact suitable legislation for instituting the provisions of the Cape Town Convention. The situation in this regard and the challenges identified as below, are fully outlined in the Sections on Legal and Regulatory reforms recommended herein/

4.7 Analysis and Recommendations on Legal and Regulatory Interventions

The examination of certain Indian laws (including delegated legislation) that are relevant for Indian banks, financial institutions, foreign lessors and high net-worth individuals for undertaking aircraft financing/ leasing business from IFSC was carried out with a focus was on the following:

In this section, certain Indian laws (including delegated legislation) have been examined that are relevant for Indian banks, financial institutions, foreign lessors and high net-worth individuals for undertaking aircraft financing/leasing business from International Financial Services Centre (IFSC). In particular, the focus has been on:

a. The existing regulatory framework pertaining to banks, financial institutions (such as NBFCs and insurance companies), foreign lessors and high net-worth individuals, provisions that could restrict undertaking of aircraft leasing/financing activities through International Financial Services Center ("IFSC") in Gujarat International Finance-Tec City ("GIFT City"), and provisions that could potentially enable such activities.

b. Legislative/ Regulatory reforms that could potentially make aircraft leasing/ financing activities out of IFSC in GIFT City more attractive.

c. Tax implications of the proposed activities and potential mitigation strategies.

d. Other related issues under relevant laws which may need to be addressed for undertaking such activities from IFSC in India.

Regulatory issues relating to banking and financial institutions have been dealt with in Part A, and issues relating to tax have been dealt with in Part B.

For the analysis, the typical structure of an aircraft sale and lease back transaction described below has been assumed.

The financing entity/ financing consortium (banks, financial institutions, foreign lessors and/or high net-worth individuals) will establish a leasing entity ("Leasing Company") in IFSC at GIFT City. This SPV will enter into a sale and lease back transaction for aircraft with an Indian airline ("Lessee"), whereby: (a) the Leasing Company in IFSC will acquire the Lessee's rights with respect to the aircraft under an aircraft purchase agreement between the Lessee and an aircraft manufacturer; and (b) the Leasing Company in IFSC will enter into a lease agreement ("Lease") with the Lessee, pursuant to which the Lessee will take the aircraft either on an operating lease or finance lease from the Leasing Company. The Lease will be for a period shorter than the entire life of the aircraft. Under the Lease the Lessee will pay lease rentals on a monthly basis in advance, and payments in relation to maintenance, repair and overhaul, which have not been otherwise covered under the 'Power-by-the-Hour' clause with the OEM aircraft manufacturer. In the context of the Leasing Company the following is relevant: (a) The Leasing Company in IFSC may be financed by the bank/ financial institution/foreign lessor/ HNI/ consortium through a combination of debt and equity; and (b) where the Leasing Company is established by a consortium, each member of the consortium need not hold a significant stake in the equity of the Leasing Company in an IFSC.

S. NO.	PARTICULARS	BACKGROUND	PROPOSAL	REGULATIONS AND AUTHORITY
		BANKS		
1.	Undertaking aircraft financing/ leasing through a subsidiary of the bank established in IFSC	Section 6(1) read with Section 19 of the Banking Regulation Act, 1949 **(BR Act)**, limits the types of business that a bank or its subsidiary is permitted to undertake. However, the Government of India may, under Section 6(1)(o) of the BR Act, notify other permissible activities. The Government of India, by a notification dated August 14, 1984, issued under Section 6(1)(o) of the BR Act **(1984 Notification)**, notified 'equipment leasing' as a permitted business activity for a bank. The Reserve Bank of India **(RBI)** has issued notifications governing the 'equipment leasing' activities of a bank and its subsidiary (Financial Services provided by Banks) Directions, 2016) **(Master Directions (Financial Services by Banks))**. Based on general interpretation, as well as Indian Accounting Standard – 16, 'aircraft' should qualify as 'equipment' for this purpose, but no specific definition or other guidance is provided under the BR Act or Master Directions on this point. Separately, the RBI, with the approval of the Central Government, has the power (under Section 19(1)(c) of the BR Act), to identify other permissible activities for a subsidiary of a bank on the grounds of 'public interest' or 'spread of banking in India'.	(i) It would be good to have the RBI confirm that 'aircraft' are within the meaning of 'equipment' and aircraft leasing would qualify as equipment leasing activity permitted for banks to undertake under the Master Directions (Financial Services by Banks) read with the 1984 Notification under Section 6(1)(o) of the BR Act. Other alternatives: (ii) The Central Government may specifically notify aircraft financing/ leasing as a permitted activity for banks under Section 6(1)(o) of the BR Act. (1984 Notification is one such precedent). (iii) RBI (with prior approval of the Central Government (in this case the Ministry of Finance)) may notify (under Section 19(1)(c) of the BR Act) aircraft financing/ leasing as an activity that can be undertaken by a subsidiary of a bank on account of it being useful or necessary in 'public interest' or 'spread of banking in India'. (No precedents).	*Confirmation by the RBI on the interpretation of the term 'equipment' under the Banking Regulation Act, 1949 and Master Directions – Reserve Bank of India (Financial Services provided by Banks) Directions, 2016* *Notification under Section 6(1)(o) of the BR Act to be issued by the Ministry of Finance, Central Government.* *Notification under Section 19(1)(c) of the BR Act by the RBI after approval of the Ministry of Finance, Central Government.*
2.	Undertaking aircraft financing/ leasing through bank unit in IFSC in - Gujarat International Finance-Tec City **(GIFT City)**	Banks in India are permitted to establish branches in IFSC pursuant to the Notification S.O. 968 (E) issued by the Government of India on April 8, 2015 read with the associated Foreign Exchange Management (International Financial Services Centre) Regulations, 2015 **(FEMA IFSC Regulations)**. However, the scope of activities that banks established in IFSC are permitted to undertake have been specified by the RBI under its circular dated 1 April 2015 on setting up of International Financial Services Centre **(IFSC)** Banking Units and the amendments thereto **(IBU Circular)**. At present, the list of permitted activities does not include 'equipment leasing' or 'aircraft leasing'. The IBU Circular also does not permit a bank branch in IFSC to invest in the capital of a company (such as an entity engaged in aircraft financing/ leasing) established in IFSC.	The RBI may amend the IBU Circular to permit bank branches in IFSC to (a) undertake equipment leasing either through a branch or a subsidiary, and (b) invest in the capital of an aircraft financing/ leasing entity established in IFSC (whether or not a subsidiary established by the bank branch). (The IBU Circular has from time to time been amended to expand the list of permitted activities, for e.g. 2016 amendment added underwriting/arranging of INR overseas bonds, foreign exchange escrow accounts for ADR/GDR issue, derivative transactions etc.)	*Amendment by the RBI to the IBU Circular to include equipment leasing and investment in capital of leasing entities.*

S. NO.	PARTICULARS	BACKGROUND	PROPOSAL	REGULATIONS AND AUTHORITY
		NON-BANKING FINANCIAL COMPANIES (NBFCs)		
1.	Undertaking aircraft leasing/ financing activities through NBFC in IFSC	Any entity: (a) whose financial assets constitute more than 50 per cent of its total assets; and (b) whose income from financial assets constitute more than 50 per cent of its gross income (as per their financial statements), are required to obtain registration as NBFCs from the RBI to continue to operations. Under Section 45I(c) of the RBI Act, 1934, an entity which carries on business of 'industrial activity' is excluded from the definition of 'financial institution'. The term 'industrial activity' as defined under the Industrial Development Bank Act, 1964 (which has now been repealed) includes 'leasing, sub-leasing or giving on hire or hire purchase of industrial plants, equipment, machinery or other assets including vehicles, ships and aircraft.' Even though the IDB Act is now repealed, the definition of industrial activity is incorporated into the RBI Act by reference. This raises ambiguity that an aircraft leasing entity which meets the 50:50 financial income test mentioned above may still not qualify as an NBFC due to the above exception for industrial activity.	Earlier 'Equipment Leasing' was expressly classified as an NBFC activity by the RBI, but this was later changed to the category of 'asset finance company'. At the same time, even the FDI policy contemplated "leasing & finance" as an NBFC permitted activity (later clarified by the RBI as financial leasing activity and not in operating leases). We understand that various leasing entities have obtained registration as NBFCs with the RBI. The RBI may confirm that equipment leasing/aircraft leasing entities would be eligible to register as NBFCs in IFSC under Section 45I(c) of the Reserve Bank of India Act, 1934 and relevant amendments in RBI (IFSC) Regulations	*RBI to provide confirmation that equipment leasing/aircraft leasing entities would be eligible to register as NBFCs in IFSC under Section 45I(c) of the Reserve Bank of India Act, 1934.*
2.	Undertaking aircraft financing/ leasing activities through NBFC set up in an IFSC	FEMA IFSC Regulations contemplate 'non-banking financial companies' as a category of companies that may set up operations in IFSC. However, the FEMA IFSC Regulations state that a financial institution established in IFSC shall conduct business in the manner that the relevant regulatory authority may determine (in this case the RBI). Unlike the IBU Circular issued in respect of banks, the RBI has not yet issued directions in relation to activities that NBFCs can carry out in IFSC.	The RBI has the power under the FEMA IFSC Regulations to issue regulations for the operation of NBFCs in an IFSC similar to the IBU Circular issued for banks.	*The RBI to issue regulations for the operation of NBFCs in an IFSC similar to the IBU Circular issued for banks.*
		ALTERNATIVE INVESTMENT FUNDS (AIFs)		
1.	Financing of entities engaged in aircraft financing/ leasing by AIF	Of the three existing categories of AIFs, Category II AIF (i.e. private equity or debt fund) are the most plausible option for routing High Net Worth Individuals **(HNI)** funds into entities engaged in aircraft financing/ leasing. However, Category II AIFs are subject to the following concentration limit: A Category II AIF is not allowed to invest more than 25% of its corpus (i.e. the total amount of funds committed by investors) in one investee company.	SEBI may be requested to amend the SEBI (AIF) Regulations, 2012 to create a separate category of AIFs for investments in aircraft leasing companies. Alternately, SEBI may permit greater concentration of investments by AIFs in entities engaged in aircraft financing/ leasing.	*Amendment of the SEBI (Alternative Investment Funds) Regulations, 2012 to create a separate category of AIFs for investments in aircraft leasing companies OR to permit greater concentration of investments in entities engaged in aircraft financing/ leasing.*
2.	Categories of investors that can invest in an AIF operating out of IFSC	An AIF operating in an IFSC can accept investments from the categories of investors prescribed under SEBI (International Financial Services Centers) Guidelines, 2015 which include (a) person resident outside India, (b) non-resident Indian, (c) institutional investor resident in India, and (d) person resident in India having a net worth of at least USD 1 million, to the extent allowed in the Liberalized Remittance Scheme i.e. an investment of up to a maximum of USD 2,50,000. It is unclear which categories of investors (as identified under the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004) would be permitted to invest in GIFT IFSC AIFs, given that the term 'institutional investors' is not defined under the SEBI guidelines or the said foreign exchange regulations. In addition, the scope for AIF to raise funds from Indian residents is very limited.	The RBI and SEBI may be requested to amend the SEBI (International Financial Services Centers) Guidelines, 2015 and associated foreign exchange regulations to: (a) specify which types of entities would qualify as institutional investors, (b) provide additional routes under Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 for Indian residents to invest in such AIFs.	*SEBI to provide clarification on types of institutional investors contemplated under the SEBI (International Financial Services Centre) Guidelines, 2015.* *RBI to provide additional relaxation under the Liberalised Remittance Scheme for Indian residents to invest in AIF operating in an IFSC.*

S. NO.	PARTICULARS	BACKGROUND	PROPOSAL	REGULATIONS AND AUTHORITY
3.	Investment by a domestic AIF in an aircraft financing/ leasing company operating out of IFSC	A domestic AIF is permitted, subject to prior approval from SEBI, to invest up to 25% of its investible funds of each scheme in equity and equity linked instruments of offshore venture capital undertakings (i.e. overseas unlisted entities) as provided in the SEBI Circular dated October 1, 2015. It is unclear whether aircraft leasing entities located in IFSC would qualify as offshore venture capital undertakings for this purpose. A similar restriction is under the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004. Further, there is an overall cap of USD 750 million on overseas investments by all AIF in India, which is available on a first come-first serve basis. This overall limit is very restrictive in the context of aircraft financing. Also, the Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 with respect to overseas investments by domestic AIFs do not clearly permit AIFs to invest in overseas debt instruments (whether listed or unlisted). residents is very limited.	(i) SEBI may be requested to clarify whether the 25% cap on overseas investments set forth under the SEBI Circular dated October 1, 2015, would apply to investments by an AIF into entities engaged in aircraft financing/ leasing out of IFSC. (ii) RBI may be requested to provide additional relaxations (such as non-applicability of the overall cap of USD 750 million in respect of overseas investments by all AIFs in India) for AIFs targeting investments in entities engaged in aircraft financing/ leasing out of IFSC. (iii) RBI may allow overseas investments by AIFs in debt instruments (whether listed or unlisted) issued by NBFCs set up in IFSC.	*SEBI to clarify under SEBI Circular dated October 1, 2015 and RBI to clarify under FEM (Transfer or Issue of Foreign Security) Regulations, 2004 position on investment by AIFs in IFSC (domestic or offshore).* *RBI (under FEMA (Transfer or Issue of any Foreign Security) Regulations, 2004) to provide relaxation to the overall cap of USD 750 million or specify non-applicability of the overall cap (in respect of overseas investments by all AIFs in India) for AIFs targeting investments in entities engaged in aircraft financing/ leasing out of IFSC.* *RBI to amend FEM (Transfer or Issue of Any Foreign Security) Regulations, 2004 to permit investments by AIFs in debt instruments (whether listed or unlisted) issued by NBFCs set up in IFSC.*
		PENSION FUNDS		
1.	Investment by pension funds	Pension funds are not specifically allowed to invest in the equity of private entities. Pension funds are not permitted to invest funds of subscribers outside India either directly or indirectly. However, it is unclear whether this restriction would also apply to investment by pension funds into (a) leasing entities established in IFSC, or (b) domestic Category-II AIFs which in turn provide finance to leasing entities established in IFSC.	PFRDA may be requested to clarify whether the restriction on pension funds to invest funds of policyholders outside India (either directly or indirectly) would apply to investments by pension funds money into entities established in IFSC or in domestic Category-II AIFs that are in turn investing in aircraft financing/ leasing entities located in an IFSC. PFRDA may permit pension funds to invest in equity or debt of companies located in an IFSC	*PFRDA can clarify under the Pension Fund Regulatory and Development Authority Act, 2013, that pension funds are permitted to invest in domestic AIFs, even if they may use funds for investments into aircraft financing/ leasing entities located in IFSC, or that investment into IFSC entities would not be considered as overseas investment by pension funds.* *PFRDA to amend the investment guidelines to allow pension funds to invest in equity or debt of companies located in an IFSC*
		INSURANCE COMPANIES		
1.	Financing of entities engaged in aircraft financing/ leasing by insurance companies	An insurer is (a) not permitted to invest or keep invested in the shares or debentures of any private limited company as provided under Section 27A(4) of the Insurance Act, 1938. Insurance companies are permitted to invest only within the exhaustive category of investments listed in the IRDAI (Investment) Regulations, 2016 (which does not include equity/ debt of entities engaged in aircraft financing/ leasing located in an IFSC. Insurance companies are permitted to invest only 70% of their 'controlled funds' in secured listed debt securities	Central Government may notify that insurers (acting out of their domestic operations outside IFSC) to invest in aircraft financing/ leasing companies which are established as companies in IFSC. However, the Central Government is empowered under Section 2CA of the Insurance Act, 1938 to exempt insurance companies from any provisions of the Insurance Act, 1938 with or without modifications. The Central Government may be requested to issue a notification exempting insurers acting out of IFSC (including branches of Indian insurance companies in IFSC) from the restrictions under Section 27A(4). Consequent amendments would also be necessary under the exhaustive list of permitted investments for an insurance company as prescribed by IRDAI, and IRDAI may be requested to provide such amendments. (There have been notifications issued by the Ministry of Finance under Section 2CA for exempting insurance companies located in IFSC from certain provisions of the Insurance Act).	*The Ministry of Finance, Central Government to issue notification under Section 2CA of the Insurance Act, 1938 to exempt insurance companies in IFSC from the investment restriction provisions under Section 27A(4) of the Insurance Act, 1938.* *Consequent amendments to the list of permitted investments under the IRDAI (Investment) Regulations, 2016, to relax investment by insurers in equity and listed debt securities, and permit investment in unlisted debt securities of companies undertaking aircraft leasing.*

S. NO.	PARTICULARS	BACKGROUND	PROPOSAL	REGULATIONS AND AUTHORITY
2.	Financing of entities engaged in aircraft financing/ leasing located in an IFSC by insurance companies set up in IFSC	The IRDAI (Registration and Operations of IIO) Guidelines, 2017 **(Insurance IIO Guidelines)** prescribes that the sole object of IFSC Insurance Offices **(IIO)** shall be to exclusively carry on insurance or reinsurance business from an IFSC and such entities shall not engage itself in any business other than those permitted by the IRDAI.	The IRDAI may be requested amend the Insurance IIO Guidelines to permit insurance companies set up in IFSC to invest in entities engaged in aircraft financing/ leasing located in an IFSC.	*IRDAI to amend the IRDAI (Registration and Operations of IIO) Guidelines, 2017* *to permit insurance companies set up in IFSC to invest in entities engaged in aircraft financing/ leasing located in an IFSC.*
3.	Financing of entities engaged in aircraft financing/ leasing set up in an IFSC by insurance companies	Insurance companies are not permitted to invest funds of policyholders outside India either directly or indirectly.	The IRDAI may be requested for a clarification that investment by Indian insurers into entities engaged in aircraft financing/ leasing located in an IFSC is not regarded as overseas investments or a legislative amendment to this effect.	*Clarification from IRDAI under the Insurance Act that investment of policyholders' funds into IFSC will not be regarded as overseas investments.* *Alternately, the Ministry of Finance may notify under S.2CA of the Insurance Act that insurance companies/branches in IFSC are exempted from the restriction on overseas investment.*
MUTUAL FUNDS				
1.	Financing of entities engaged in aircraft financing/ leasing by mutual funds	Mutual Funds are not permitted to invest in unlisted equity/equity linked instruments of foreign companies. Further, under RBI regulations, mutual funds are permitted to invest in foreign debt securities in the countries with fully convertible currencies, short term as well as long term debt instruments with rating not below investment grade by accredited / registered credit rating agencies. Mutual funds' investments are subject to the following restrictions: Mutual funds are not allowed to invest more than 10% to 12% of its NAV in rated debt instruments, 10% to 25% of its NAV in unrated debt instruments and 5% to 10% of its NAV in unlisted equities.	SEBI may be requested to amend the SEBI (Mutual Funds) Regulations, 1996 to create a separate category of mutual funds for investments in aircraft leasing companies in IFSC. The RBI may amend the existing regulatory framework to permit investments in overseas unlisted equity/equity linked instruments. SEBI may also permit greater investments by mutual funds in unlisted debt and equity instruments issued by entities engaged in aircraft financing/ leasing set up in IFSC.	*Amendment of the SEBI (Mutual Funds) Regulations, 1996 to create a separate category of mutual funds for investments in aircraft leasing companies in IFSC* *RBI to amend FEM (Transfer or issue of any Foreign Security outside India) Regulations, 2004 to permit investments by mutual funds in unlisted equity/equity linked instruments, and foreign debt instruments issued by entities engaged in aircraft leasing set up in IFSC.* *Amendment of the SEBI (Mutual Funds) Regulations, 1996 to permit greater concentration of investments in unlisted debt or equity of such entities.*
2.	Categories of investors that can invest in a mutual fund operating out of IFSC	A mutual fund operating in an IFSC can accept investments from the categories of investors prescribed under SEBI (International Financial Services Centers) Guidelines, 2015 which include (a) person resident outside India, (b) non-resident Indian, (c) institutional investor resident in India, and (d) person resident in India having a net worth of at least USD 1 million, to the extent allowed in the Liberalized Remittance Scheme i.e. an investment of up to a maximum of USD 2,50,000. It is unclear which categories of investors (as identified under the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004) would be permitted to invest in IFSC mutual funds, given that the term 'institutional investors' is not defined under the SEBI guidelines or the said foreign exchange regulations.	The RBI and SEBI may be requested to amend the SEBI (International Financial Services Centers) Guidelines, 2015 and associated foreign exchange regulations to: (a) specify which types of entities would qualify as institutional investors, (b) provide additional routes under Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 for Indian residents to invest in such mutual funds.	*SEBI to provide clarification on types of institutional investors contemplated under the SEBI (International Financial Services Centre) Guidelines, 2015.* *RBI to provide additional relaxation under the Liberalised Remittance Scheme for Indian residents to invest in mutual funds operating in an IFSC.*

S. NO.	PARTICULARS	BACKGROUND	PROPOSAL	REGULATIONS AND AUTHORITY
		EMPLOYEES PROVIDENT FUND ORGANIZATION		
1.	*Investment by Employees Provident Fund Organization (EPFO)*	Under a notification dated 23 April, 2015 by the Ministry of Labour and Employment, the EPFO is not permitted to invest provident funds into private companies or domestic AIFs.	The Central Government (through Ministry of Labour and Employment) may be requested to issue a notification to permit investments in companies engaged in aircraft financing/leasing set up in IFSC, and in AIFs in IFSC	*The Central Government (through Ministry of Labour and Employment) to issue a notification to permit investments in companies engaged in aircraft financing/leasing set up in IFSC, and in AIFs in IFSC*
		FOREIGN LENDERS - ECBS UNDER AUTOMATIC ROUTE (FOR PDP FINANCING)		
1.	Minimum Average Maturity Period restrictions, All-in cost requirements, Eligible lenders specified.	These minimum average maturity stipulations restrict the use of the automatic ECB route for PDP Financing. The 'all in cost ceiling' caps the returns for the lender on financing through this route Given the restricted list of recognized lenders, the lender for the PDP Financing cannot be an entity that does not fall under one of the items on the list. The permitted end-use in the ECB Master Directions state that Indian airline companies cannot raise ECBs for working capital purposes or for general corporate purposes under Track I and Track III.	RBI may be requested to issue specific directions to provide specific exceptions for Indian airline companies from these minimum maturity requirements and 'all in cost ceiling' caps. Leasing/financing SPVs should qualify as eligible lenders after they are recognized as 'financial institutions' in IFSC (by virtue of being NBFCs) and regulated as such. A notification to the effect that pre-delivery payments are not covered under the term 'general corporate purposes' is required for abundant clarity to allow airlines to avail PDP Financing under this route.	*RBI to issue specific directions under Section 11 of Foreign Exchange Management Act, 1999 to provide specific exception for Indian airline companies from these minimum maturity requirements and 'all in cost ceiling' caps* *RBI to issue a notification clarifying that raising finances for making PDPs would not be classified as a 'general corporate purpose' (this only arises because of the SLB arrangements)..*
2.	New route for PDP Financing	Under the ECB Master Directions, airlines are permitted to raise ECB Financing to meet their working capital requirements. This route is subject to the minimum average maturity stipulation of 3 years. The debt needs to be repaid out of foreign exchange earnings of the airline and not from domestic Rupee earnings, thereby making this route unattractive to domestic airlines.	RBI may be requested to issue a notification enabling airlines to use this route to avail for availing PDP Financing. Alternatively, RBI may be requested to issue separate guidelines to address PDP Financing availed by airlines as well.	*RBI to issue a notification under the ECB Master Directions enabling airlines to use this route to avail PDP Financing.* *Alternatively, RBI may issue separate guidelines to address PDP Financing availed by airlines as well.*
		FOREIGN LENDERS - ECBS UNDER APPROVAL ROUTE (FOR PDP FINANCING)		
1.	ECB proposals beyond the limits provided under the automatic route require prior RBI approval	Under the approval route, borrowers are required to make an application to the RBI through an AD Bank which considers such cases keeping in view parameters such as the current macroeconomic situation and merits of specific proposals. The RBI website provides an indicative timeline of 30 days for procuring approvals in respect of ECB financing (though timelines are variable and differ significantly on a case to case basis).	RBI may be requested to increase the individual limits of ECB that can be raised by airlines (for PDP Financing specifically) under the approval route (from current limit of USD 500 million) In the event that the RBI is reluctant to bring PDP financing under the automatic route, the RBI may be requested to make a special dispensation under the approval route for PDP financing whereby: (a) the parameters under the approval route are suitably modified for the PDP financing structure; and (b) the timeline for approval of such transactions is compressed subject to the transaction meeting certain criteria pre-defined by the RBI.	*RBI to issue specific directions under Section 11 of the FEMA Act increasing the individual limits of ECB that can be raised by airlines (for PDP Financing specifically) under the approval route* *Or the RBI to issue regulations under the approval route for PDP financing making special dispensation under the approval route whereby the parameters under the approval route are suitably modified for the PDP financing structure and the timeline for approval of such transactions is compressed subject to the transaction meeting certain criteria pre-defined by the RBI.*

S. NO.	PARTICULARS	BACKGROUND	PROPOSAL	REGULATIONS AND AUTHORITY
FOREIGN LENDERS - TRADE CREDITS (FOR PDP FINANCING)				
1.	*Trade credits relate to 'Import into India'*	The definition of the term 'trade credit' refers to credit for the 'imports into India'. This poses a problem in the context of a typical PDP Financing transaction because of the fact that the rights under the contract are usually assigned to the leasing entity and therefore the airline will not, in most cases, take delivery of the aircraft from the vendor and import it into India.	The RBI/ DGFT may be requested to clarify the meaning of 'import into India' in the context of PDP Financing transaction, to ensure that the transaction qualifies as an 'import' despite the arrangement with the leasing entity.	*RBI/ DGFT to issue a clarification in respect of the meaning of 'import into India' in the context of PDP Financing transaction.*
2.	*Cap on Automatic Route*	Trade credit exceeding USD 20 million that is availed for the purpose of importing capital goods (such as aircraft), requires prior RBI approval. As with ECBs, timelines for procuring approvals in respect of availing trade credit are variable and differ significantly on a case to case basis.	The RBI may be requested to introduce an enhanced limit under the automatic route specifically for PDP Financing of aircraft. (so as to bypass the approval requirements).	*The RBI to notify enhanced limits under the automatic route specifically for PDP financing of aircrafts.*
3.	*All in cost ceiling caps and initial contract period requirements*	As with ECBs, the ECB Master Directions impose an all-in-cost ceiling on trade credits; In respect of trade credit up to five years for capital goods, the initial contract period should be 6 months.	The RBI may be requested to provide a specific exemption from the all in cost ceiling caps and initial contract period for airline companies.	*The RBI to provide specific exemption under Section 11 of the FEMA Act from the all in cost ceiling caps and initial contract period for airline companies, if required.*
DEREGISTRATION AND REGULATION OF AIRCRAFTS / APPLICABILITY OF SARFAESI ACT				
1.	*Right to detain aircraft*	There have been legal as well as practical impediments for deregistration and repossession of an aircraft due to lack of air operator's consent or claims raised by revenue and airport authorities.	A clarification/ proviso under the Aircraft Rules to the effect that the aircraft of the lessors cannot be detained in relation to any statutory amounts payable by the lessee. In order to streamline and bring transparency to the process of export of an aircraft under Rule 32A of the Aircraft Rules, the DGCA on November 16, 2018 issued AIC 12/ 2018 - the Standard Operating Procedure ("SOP"). The SOP generally provides for a mechanism for export under Rule 32A of the Aircraft Rules and inter alia provides the following: 5. *"The airport operators will calculate the outstanding dues related to the aircraft in question* ***for a period of three months*** *immediately preceding the* ***date of declared default*** *i.e. the date on which the request for deregistration was received in DGCA, and raise bills within five working days of the first e-mail received from DGCA as per para 3. Any dues prior to three months preceding the date of declared default shall not be included in the aforesaid calculation. The airport operator will forward the bills to the IDERA Holder by e-mail with copy to DGCA and will also indicate the necessary bank details to enable electronic payment.*	*The Government has proposed a draft Cape Town Convention Bill, 2018 which, when enacted, will ensure full implementation and give overriding effect to CTC.* *The above shall to a great extent be able to address the grey areas with respect to CTC, particularly, and without limitation, claims raised by revenue et al.*

S. NO.	PARTICULARS	BACKGROUND	PROPOSAL	REGULATIONS AND AUTHORITY
			6. ***<u>Any other organization covered under the proviso to sub-rule (7) of rule 30 and having outstanding dues pertaining to the aircraft in question, may also raise bills and intimate DGCA about it within five working</u>*** *days from the date of declared default. DGCA will inform the IDERA Holder by e-mail about such liability also if notified within five working days of the date of declared default. DGCA will not be responsible for any dues that are not notified to it within the specified period of five working days." (Emphasis supplied)* The SOP, provides for a timeline within which the authorities mentioned in the proviso to Rule 30(7) of the Aircraft Rules must raise their claim and the time period (3 months immediately preceding the date of declared default) for which such a claim must be made. It is important to note that though these dues are primarily a lessee liability, the Lessor is provided with a reasonable opportunity to repossess the aircraft. In the same line, Rule 10 of the Airports Authority of India (Management of Airports) Regulation, 2003 has been amended by a Notification dated November 16, 2018 to include the following proviso: "Provided that in respect of an aircraft which is to be exported under Rule 32A of the Aircraft Rules, 1937, the current and accumulated dues shall include only such dues that accrued in respect of that aircraft and in relation to flights operated by that aircraft during the period comprised of three months immediately preceding the date of declared default up to the date of departure of the aircraft from India. Provided further that the Authority shall retain the right to recover the balance dues, if any from the concerned airline. Explanation: For the purposes of this regulation, the date of declared default means the date on which the application for deregistration of the aircraft has been submitted to the Directorate General of Civil Aviation under the Aircraft Rules, 1937."	
2.	*Non-applicability of SARFAESI to aircraft*	The SARFAESI Act is not applicable to the creation of any security over aircrafts. Accordingly, the benefits that are otherwise available to the lenders under the SAFAESI Act are not available to aircraft leasing companies.	The Central Government may be requested to amend Section 31(c) of SARFAESI Act to delete the exception with respect to aircrafts.	*Central Government to amend Section 31(c) of SARFAESI Act to delete the exception with respect to aircraft*

S. NO.	PARTICULARS	BACKGROUND	PROPOSAL	REGULATIONS AND AUTHORITY
		STAMP DUTY		
1.	Stamp duty exemptions	The Gujarat Special Economic Zone Act, 2004 **(Gujarat SEZ Act)** does not provide complete exemption from levy of stamp duty on all instruments executed in aircraft financing/leasing transactions, resulting in high cost attributable to stamp duty payments.	The Gujarat state government may be requested to amend S. 21 of the Gujarat SEZ Act to provide specific exemption from payment of stamp duty on instruments executed in connection with aircraft financing/leasing transactions carried out from GIFT SEZ IFSC	*Gujarat state government to amend the Gujarat SEZ Act to provide specific exemption from payment of stamp duty on instruments executed in connection with aircraft financing/leasing transactions carried out from GIFT SEZ IFSC*
2.	Permitting existing Airline operators to set up a branch office in the IFSC	Currently, all the Airlines have set up their presence in India in the form of a company with its registered office in Delhi or Mumbai (mostly). However, the idea of opening their office in an SEZ has not been explored or thought of	With the advent of a financial SEZ in GIFT City and the promotion of aircraft financing / leasing from the IFSC, Airlines could consider setting up a Branch office in the IFSC at GIFT City	DGCA to issue a notification / clarification to this effect permitting Airlines to set up a branch office in the IFSC
3.	Including DGCA as one of the regulators for an IFSC in respect of aviation financing / leasing	Currently, the Ministry of Commerce and Industry vide Notification dated 08 April 2015 has included SEBI, RBI and the IRDAI as approved regulators for any financial service activity at the IFSC. However, aviation financing was not included as a specific sector and hence, any Airline were to set up an office in the IFSC, it will only be treated as an SEZ unit as against global practices where such lessors are considered on par with financial service providers	Given the context of promotion of aircraft financing / leasing from the IFSC and also the option of the Airlines setting up a branch in the IFSC, inclusion of DGCA as one of the regulators will also facilitate the Airlines in being considered as IFSC units.	Ministry of Commerce and Industry to amend notification

PART B – TAX

S. NO.	PARTICULARS	BACKGROUND	PROPOSAL	REGULATIONS AND AUTHORITY
		INDIRECT TAXES		
1.	**Exemption of Import IGST on import of aircraft by Indian leasing company**	Import IGST is exempt for goods imported by a unit in SEZ for authorized operations as per notification no. 64/2017- Customs. However, it is not clear as to whether an Indian leasing company needs to import the aircraft physically within the SEZ area to avail such exemption.	Notification no. 64/2017 – Customs to be amended to clarify that aircraft need not be physically imported within the SEZ area to claim exemption of import of goods (aircraft).	Ministry of Finance (through CBIC) and GST Council As a matter of process, recommendation will be made by GST Council which must be implemented by the Central and State Governments
2.	**Dispense requirement of the aircraft being physically required to enter the SEZ area and that the lease rental paid to specifically count toward Net Foreign Exchange (NFE)**	Notification 64/2107 -Customs dated 5 July 2017 exempts all goods imported by an SEZ unit for undertaking authorized operations. However, to enable this exemption being made available for leasing operations carried out by a Leasing Company in a IFSC, the SEZ legislation is required to be amended. Section 26(1)(a) of the SEZ Act, provides that imports by an SEZ unit are exempt from customs duty, only if: (i) Such goods are used for 'authorized operations'; and (ii) Goods are physically brought into the SEZ unit; Therefore, to claim exemption from customs duty, the aircraft must be physically brought into the SEZ unit, which may not be practically possible by an IFSC	SEZ legislations may be suitably amended to dispense (i) requirement of aircraft being physically required to enter the SEZ area (and stay therein); and (ii) It should be clarified that any amount received by Indian leasing company should be counted towards Net Foreign Exchange (NFE)	Ministry of Commerce
3.	**Exempt GST on airplane lease rentals**	Leasing of aircrafts is subject to GST at the rate of 5%. The airline companies availing the leasing service do not get full input tax credit to the extent of their exempt income which includes passenger fare for flights embarking from or terminating to certain north-eastern states, transaction in securities etc.	GST on leasing of aircraft by domestic leasing company to Indian operators should be made zero-rated	Ministry of Finance (through CBIC) and GST Council As a matter of process, recommendation will be made by GST Council which must be implemented by the Central and State Governments
4.	**Permit input GST credit on goods (aircraft and parts thereof) for lessor** **This is not relevant if the IGST exemption (under S.No. 1 or 2) is granted**	Lease of aircraft is subject to GST at the rate of *5%; credit of input tax charged on goods used in supplying the 'leasing service' (basically the aircraft and parts thereof) is not available*	The restriction on GST credit on goods (basically aircraft and parts) used for leasing services should be removed. Specifically entry (iv) of 8/2017 should be amended/ deleted or a clarification be issued that entry 9971(ii) would be the relevant entry for leasing of aircraft by an Indian Leasing Company *There is ambiguity on whether sub-entry (ii) or (iv) of entry 9971 would apply in cases of lease of aircraft.*	Ministry of Finance (through CBIC) and GST Council As a matter of process, recommendation will be made by GST Council which must be implemented by the Central and State Governments
5.	**Grant refund to lessor of any accumulated input tax credit on goods and services**	There may be accumulated input tax credit for Indian leasing company in IFSC for reasons such as non-availability of exemption on import of aircraft etc.	Indian leasing company should be allowed refund of any accumulated input tax credit	Ministry of Finance (through CBIC) and GST Council As a matter of process, recommendation will be made by GST Council which must be implemented by the Central and State Governments

S. NO.	PARTICULARS	BACKGROUND	PROPOSAL	REGULATIONS AND AUTHORITY
		DIRECT TAXES		
6.	**Exemption from withholding tax on interest paid by leasing entity in IFSC**	Interest paid by a Leasing Company in IFSC to any lender is currently subject to withholding tax requirements which consequently results in a higher financing cost for the aviation sector.	Interest paid by a Leasing Company in IFSC to any lender should be exempt from withholding tax requirement.	Central Board of Direct Taxes/ Central Government
7.	**Exempt MAT on IFSC units**	IFSC units are subject to MAT rate of 9% which leads to cash flow problems.	To incentivize leasing companies to set up and start leasing operations in India, MAT should be exempted for aircraft lessors operating out of an IFSC for an initial period of 5 years from the date of the IFSC unit starting commercial operations, with such benefits ceasing for IFSC units set up after 2024.	Central Board of Direct Taxes/ Central Government
8.	**Tax holiday**	Tax holiday of 100% for first 5 years (100%) and 50% for next 5 years, provided under the Section 80LA of the Income Tax Act, 1961 is too less.	Given that leasing Company in IFSC is unlikely to earn profits in the initial few years; to make the current tax holiday more attractive; the tax holiday should be made available for any block of 10 consecutive years within the first 15 years of the operations of the Leasing Company in IFSC	Central Board of Direct Taxes/ Central Government
9.	**Exempt capital gains on bonds or derivatives in a unit in IFSC**	No capital gains exemption for transfer of bonds or derivatives in a unit in IFSC by a resident investor	Extend capital gains exemption, currently available only to non-residents in respect of transfer of bonds, derivatives in a stock exchange in an IFSC, to a resident investor in a leasing company	Central Board of Direct Taxes/ Central Government
10.	**Exempt capital gains tax or concessional capitals gains tax on sale/resale of aircraft**	Sale/resale of aircrafts by leasing companies is liable to capital gains tax under Section 45 of the Income Tax Act, 1961. Currently, capital gains exemption is only available in respect of certain securities and derivatives for non-resident investors	Capital gains tax on sale/ resale of aircraft by a leasing company in IFSC should be fully exempted.	Central Board of Direct Taxes/ Central Government
11.	**Increased deduction for airline companies on lease rentals paid to leasing companies in the IFSC**	100% deduction is currently available on the lease rentals paid by airlines to leasing companies (both located within India and outside India)	Incentivize airlines to take aircrafts on lease from leasing companies located in an IFSC by offering increased deduction to the extent of 125% of the lease rentals, if paid to leasing companies located in the IFSC	Central Board of Direct Taxes/ Central Government
12.	**Remove withholding tax on lease rentals paid by airline companies**	Lease rentals paid by airline companies on operating lease are subject to withholding tax at 2% under section 194-I of the Income Tax Act, 1961 Further, interest paid on finance lease are subject to withholding tax at 10% under 194-A	Specific exemption to be inserted providing for Nil withholding tax to be paid by airline companies on lease rentals paid to aircraft leasing companies located in IFSC, whether structured as lease rentals or finance charges	Central Board of Direct Taxes/ Central Government

S. NO.	PARTICULARS	BACKGROUND	PROPOSAL	REGULATIONS AND AUTHORITY
		DIRECT TAXES		
13.	**Reduction of useful life of aircrafts to compute depreciation – effect of reduction of MAT impact**	Schedule II under section 123 of the Companies Act, 2013 provides as follows: SCHEDULE II(See section 123) *USEFUL LIVES TO COMPUTE DEPRECIATION* *PART'A'* ….. *PART'C'* *VIII. Aircrafts or Helicopters [NESD]-20 Years*	MAT is calculated based on book profits as per the Companies Act, 2013, which provides for depreciation under the straight-line depreciation method. Further, depreciation under the Companies Act, 2013 is based on the stipulated useful life of the aircraft. Reduction of the useful life of aircraft, in the hands of a Leasing Company located in the IFSC, to 12 years under the Companies Act, 2013. This increases the amount of straight line depreciation for each accounting year, leading to a lower amount of taxable book profits, and consequently reducing or eliminating MAT implications. Notification to be issued amending the schedule	Ministry of Corporate Affairs/ Central Government
14.	**Relaxation of GAAR provisions**	The Income-tax Act, 1961 currently encompasses General Anti-avoidance Rules **(GAAR)** which deal with denial of tax benefits / incentives to tax payers where a transaction (or a step in it) is considered to have been entered into with the main purpose to avoid / evade income-tax. The Income Tax Act, 1961 provides certain tax exemptions to an entity set up in IFSC. With the objective of promoting aviation financing / leasing in IFSC, certain additional tax benefits are being proposed to be granted by the Government of India to the Indian Airline Companies and the Lessors setting up a presence in IFSC. However, if GAAR is invoked by the Income-tax authorities, there is a potential risk of denial of these Income-tax benefits / exemptions; especially where existing lease arrangements are novated/restructured to units in an IFSC. Indian Airline Companies and the Lessors setting up a presence in IFSC need certainty that GAAR provisions will not be invoked against them in order for them to consider moving to IFSC.	Clarification / notification should be issued to exclude certain transactions undertaken by Indian Airline companies with an entity in IFSC and Lessors having a presence in IFSC from the purview of GAAR provisions. Specifically, transfer/novation of aircraft financing / leasing contracts to units in an IFSC should not be under the purview of GAAR, for both the lessee and lessor. This would encourage existing leases to be transferred/ novated to Indian leasing companies set up in an IFSC. Indian government also stands to benefit from this as lease rentals currently paid to non-resident leasing companies (usually based in Ireland) escape taxation in India. Leasing companies in IFSC will pay MAT (if separate exemption from MAT is not granted) even during 100% tax holiday period and thereafter corporate income tax after expiry of tax holiday.	Central Board of Direct Taxes/ Central Government

IFSC: A KEY ENABLER FOR AIRCRAFT FINANCING & LEASING

Globally, aircraft financing business is done from International Financial Centres as they provide the required regulatory framework to support such businesses and offers competitive tax regime required to compete with global giants in lease business operating from tax efficient financial centre.

As India embarks on a mission to form new regulations for the establishment of the aircraft leasing business, the focal point for research should be on Ireland's business model for aircraft leasing companies and understanding the basis for its success.

Ireland is an attractive place for international investors to do business for a number reasons, inter alia, among the following:

- The national Government has shown full commitment to the development of the aviation finance and leasing industry holistically.
- It is a Contracting State to the Cape Town Convention and Aviation Protocol (India is as well).
- There are no thin capitalisation rules so an SPV can be established with a share capital of € 1/-.
- A low corporation tax for trading companies at 12.5%.
- An extensive double tax avoidance treaty network, with over 70 countries.
- No withholding tax on lease rental payments.
- Wide exemptions from withholding tax on interest and dividend payments.
- No stamp duty or transfer taxes on the transfer of aircraft or aircraft parts.
- Straight-line depreciation at 12.5% over 8 years.
- 0% VAT on international aviation leasing.

Further, a tax comparison with global financial centres like Hong Kong, Singapore and China was also carried out. The existing regulatory and tax framework in the sole IFSC in India which is placed at **Annex-III**, and the comparative analysis of these global financial centres with the Indian IFSC is placed at **Annex-IV**.

In order for India to make its mark and compete with massive aircraft leasing and financing companies globally, India needs to have a similar regulatory and tax regime for this industry. Thus, to sustain this model of regulatory and tax measures without affecting mainland regulations, the IFSC is the ideal location for the Aircraft Leasing companies of India.

Introduction to IFSC

The IFSC project was envisioned by the Hon'ble Prime Minister of India, while he was the Chief Minister of Gujarat as an initiative aimed at propelling the economic development of the country.

The Hon'ble Finance Minister, while delivering the Budget Speech for the financial year 2015-16 stated that the Indian IFSC would actually become as good as an IFSC in Singapore or Dubai which incidentally are largely manned by Indian nationals. During the formal launch of the IFSC at Gandhinagar, with the regulations dated April 10, 2015, he had stated that "We are trying to present a taxation regime which is internationally competitive and non-adversarial". Thereafter, the Government of India announced a competitive tax regime for IFSC in India and the same has been updated every year in order to make it internationally competitive for various businesses.

Accordingly, based on an assessment of the regulatory provisions of the IFSC vis-à-vis those applicable to the domestic tariff area in India, it was concluded by the Working Group that the IFSC project would help India establish its own Global Financial Hub to harness on the economy of agglomeration and thereby creating large number of jobs and contribute to the country's GDP.

Policy Objectives of Establishing an IFSC

IFSC seeks to bring to the Indian shores those financial services transactions that are currently carried out outside India by overseas financial institutions and overseas branches/ subsidiaries of Indian financial institutions to a centre which has been designated for all practical purposes as a location having the same ecosystem as their present offshore location, which is physically on Indian soil.

In accordance of the broad vision of the Hon'ble Prime Minister of India, which has been reproduced in the Executive Summary herein, the concept of an IFSC is simple but powerful and aims to provide onshore talent with an offshore technological and regulatory framework. The objective is to provide an opportunity for Indian professionals to undertake activities in India that are not otherwise present anywhere else in the country. It will also allow qualified professionals/ firms working outside India to carry out their financial services activities from Indian soil. Financial services make significantly important contributions to the GDP of about 5% with an estimated market capitalization of about USD 200 billion (2007), and employ a skilled and unskilled workforce of around 3 million people. By 2020, it is estimated that the financial services sector could comprise of about 10 million jobs and a GDP contribution of USD 350-400 billion.

The entire present leased fleet of Indian airlines comes from companies that provide these leasing/ financing services from mostly Ireland, Hong Kong, Singapore, the Middle East and USA. To support the objectives of developing international financial services in India so that the economic activities and employment generation benefits stays on Indian shores, the Government of India notified the IFSC to establish various regulatory and tax support for the International Financial Services Centre (Annex-III refers).

This enabling framework is key for hosting aviation financing and leasing business from IFSC in India. In order to bring the aviation financing and leasing business to India, it would be prudent to use the IFSC platform and enable it to match the Global Financial centres in terms of regulatory support and tax alignment.

Based on its analysis of the sustainability of the proposed structure and the financial model, the Working Group has identified the IFSC in Gujarat International Finance Tec-City (GIFT City) as the ideal location to nurture this industry in its infancy, due to the regulatory framework it provided to support the industry by offering a competitive tax regime to compete with global leasing giants.

The indicative financing structure in the IFSC is outlined in the Section on Principal Recommendations in Summary above, along with a detailed assessment of the current barriers in the transaction.

Financial Model and Overview of Current and Proposed Tax Regime

In order to understand the intricacies of the aircraft leasing business, a financial model was developed and key assumptions for the financial model is placed at Annex-V. Further, the current and proposed tax regime to make aircraft financing and leasing competitive at IFSC in India has been developed and the same is placed at Annex-VI.

Summary of Findings:

- Stakeholders were instantly interested.
- Indian airlines ready for domestic financing sources.
- Major Indian banks interested to foray into aircraft financing.
- Indian AIFs ready to provide financing.
- Indian insurers interested to partner and insure.
- Indian entrepreneurs interested to Start Up aircraft asset management in India.
- GIFT-City/ State Government of Gujarat showed active engagement.
- International banks ready to finance, participate.
- Foreign lessors willing to partner/ provide asset management expertise.
- Aircraft OEMs willing to actively partner.
- Government support needed for key regulatory changes in addition to suitable incentives coupled with facilitation of first set of transactions.
- Indian financiers need to be at an advantage to incubate the industry; Level playing field is not enough.
- Timing is of essence in setting up the ecosystem holistically.

Changes considered most critical for undertaking this business from IFSC in India

- RBI regulations
    - NBFC Operating Guidelines for IFSC/GIFT-City
    - To be allowed to open subsidiaries/ branch/ JV et. al. at IFSC
    - Relaxed regulatory guidelines for already existing NBFCs (without a NOC route)
    - International disclosure requirements to apply
    - Allow outlay of funds in the following sectors
        - Infrastructure, **equipment finance and leasing*** (aircraft, *aircraft leasing, etc.),
        - Asset reconstruction, Capital market – margin funding, etc.
        - Housing refinancing, factoring and bill discounting

- Exposure limit revision and permission to parent NBFC to issue guarantees (to the extent of commitment)
- Allow foreign lessors to open Branch in IFSC for leasing and financing aircraft/ engines
- Permit Bank Subsidiaries/ Bank Verticals to take up High-Value Mobile Equipment (Aircraft, Aircraft Engines, Ships, Oil Platforms, Submersibles, etc.) Leasing/ Financing
- Confirm that 'equipment' under S. 6(1)(o) notification of 14.08.1984 (issued under BR Act) and under Master Directions (Financial Services by Banks) 2016, includes aircraft and aircraft engines.
- Amendment of IBU Circular governing permitted activities by banks in GIFT City
  - to allow banks to undertake 'equipment leasing'
  - to invest in capital of SPVs undertaking aircraft leasing, and
  - to establish SPVs for aircraft financing

■ Direct and indirect tax changes

- Clarify that lessee would not be required to deduct withholding tax (2% on lease rentals; 10% on interest payments) where lessor is located in an IFSC unit/ GIFT-City
- Aircraft lease
  - Rate of withholding tax: Up to 40% in the absence of a favorable DTAA
  - Favorable jurisdiction: Ireland – NIL withholding tax
  - For aircraft lease, Indian lessee traditionally uses Ireland as lessor-jurisdiction to take advantage of favorable Indo-Irish DTAA
  - Under DTAA, when lessor does not have a permanent establishment in India, lease rental payments constitute 'business profit' and are taxable only in Ireland
- Engine lease
  - Rate of withholding tax: Up to 40% in the absence of a favorable DTAA
  - Favorable jurisdiction: The Netherlands (also, France, Israel, Belgium et. al.) – NIL withholding tax (Ireland: 10%)
  - For such lease, Indian lessee traditionally uses these jurisdictions to take advantage of Nil withholding tax

■ SOPs for deregistration/ export of aircraft in line with Cape Town Convention

■ Depreciation provision under Companies Act

■ Gujarat Stamp Act

Conclusion

It is evident from the previous sections that aviation traffic is going to rise globally in coming years. Countries like India and China backed by strong social and economic development are undergoing rapid transformation. The rise in the income level and Government support towards better regional connectivity and improved infrastructure have led to a rise in air traffic in these countries. The vision of the Government to make air travel affordable for the masses through UDAN and to connect unserved and underserved regions of the country via airways has led to a surge in air passenger traffic. This in turn has expedited the demand for addition of new aircraft by airlines operating in India. Rise in domestic demand along with the rise in air passenger and freight traffic across Asia-Pacific has led to rapid expansion of fleet by airlines.

Airlines are growing to meet the continued aviation transport demand globally and in India. During discussions they indicated a wide range of cheap financing opportunities, and outlined their attempts to evaluate all financing options, including debt (EETC), leasing, Japanese operating leases, with some also viewing debt financing as more attractive than SLBs. These airlines thus calculate an even cost – because they want to own and operate new aircraft through their useful lives. However, a very few airlines also remain active in the used aircraft market and foresee a key role for leasing to play in the used aircraft market also. Some suggested that the preference for fixed rate debt is relatable to certain points of time in the rate cycle. It is not as though attractive terms for fixed debt cannot be obtained in the SLB market. The financings in the Japanese operating lease market, which is typically a floating rate product, is now also under transformation to offer fixed rate Japanese operating leases. Returns on midlife/ mature aircraft leases used to be in the mid-teens, and they are now in the single digits. Midlife players are having to look at more unique assets in order to find adequate returns. This is just a flavour of the rich discussions the Working Group held with the airlines in India over a large number of sessions, formal and informal.

For the airlines, addition of new aircraft are expensive and ties-up large part of operators' balance sheet. Leasing enables the cost to be spread across many years and allows the operators to fly at a relatively economical price. Hence, aircraft leasing industry has a significant role to play in filling the financial gap and also assist airlines in their fleet expansion. As a result, it is not only the western countries like Ireland and the US but companies in Asian countries like China, Hong Kong, Singapore, etc. are also growing exponentially to grab a larger share of the pie. China is the most prominent example of such growth whereby the total number of major leasing companies increased from 4 in 2007 to more than 20 in 2017.

It is strongly felt that India must leverage its growing air traffic to establish a robust aircraft leasing industry which would finance new aircraft deliveries through its skilled services. In this respect, it is important that the road map for developing aircraft financing and leasing as an asset class in India developed in this Working Group and in particular the roadblocks to such development identified herein are swiftly taken up for removal in a time-bound manner with monitorable milestones set for the tasks. It is also important to quickly introduce a concessional tax regime for a certain time period and adopt relevant policy measures outlined in this Report to expedite the building of world class aircraft leasing industry in the country.

Aircraft operating leasing offers stable and predictable cash flow and hence, is a profitable sector for investors' money. This sector which is missing in India today has the potential to contribute to the growth of the economy in form of higher tax revenue collections, new employment opportunities and affordable air travel for citizens.

The Working Group found that as India embarks on a mission to establishing an aircraft financing and leasing industry, to attract competitive financing, insurance, leasing and associated activities, it would be both efficient and effective to focus on the global market leader Ireland's blueprints for the regulatory framework to be introduced in India. Practically speaking, the IFSC at GIFT-City, which has off-shore status for financial services to non-residents and residents to the extent permissible under the current regulations in any currency except the Indian Rupee, provides the opportune jurisdiction to launch this initiative.

The entire present leased fleet of Indian airlines comes from companies that provide these leasing/ financing services from mostly Ireland, Hong Kong, Singapore, the Middle East and USA. IFSC is the ideal enabler for the new aircraft financing and leasing operations. In order for this new aircraft financing and leasing industry to be competitive globally, it also provides a platform for the regulatory and tax exemptions required for this sector without impacting the national level regulations and taxation.

The introduction of the new aircraft financing and leasing sector will provide an opportunity for Indian professionals to undertake activities in India that are not otherwise present anywhere else in the country. It will also allow qualified professionals/ firms working outside India to also carry out their financial services activities from Indian soil.

LONG-FORM ANALYSIS OF RECOMMENDATIONS

Legal and regulatory issues relating to banking and financial institutions have been dealt with in Part A, and issues relating to tax have been dealt with in Part B.

PART A

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
I. BANKING, FINANCIAL INSTITUTIONS AND SECURITIES REGULATIONS					
Note: With each category of financers, we have considered the financer acting in the capacity of (a) financer to the entity engaged in leasing; and (b) an entity engaged in leasing itself.					
1.	***Banking Company***				
	Restrictions on activities by banks The BR Act prescribes a list of business activities (under Section 6 of that Act) that banks in India are permitted to undertake. This exclusive list of permissible business activities applies equally to all subsidiaries of a bank in India. Note that it is not necessary for a subsidiary of a bank to be a banking company itself. However, based on our understanding, such a subsidiary engaged in aircraft financing/leasing activities is likely to meet the test to be classified as a NBFC (discussed in Section 2 below).	(i) BR Act: '*Section 6 - Forms of business in which banking companies may engage:* *(1) In addition to the business of banking, a banking company may engage in any one or more of the following forms of business, namely:* *(a) the borrowing, raising, or taking up of money; the lending or advancing of money either upon or without security; the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hoondees, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scrips and other instruments and securities whether transferable or negotiable or not; the granting and issuing of letters of credit, traveller's cheques and circular notes; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange including foreign bank notes; the acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds; the purchasing and selling of bonds, scrips or other forms of securities on behalf of constituents or others, the negotiating of loans and advances; the receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise; the providing of safe deposit vaults; the collecting and transmitting of money and securities;*	***Financing by banks:*** Section 6(1)(a) of the BR Act permits all banks to engage in '*lending or advancing of money either upon or without security...negotiating of loans and advances*'. There is no restriction under this Section 6(1)(a) on lending or advancing loans by banks for financing of aircraft purchases *(however, the typical sale and lease back structure followed in aircraft financing creates challenges as discussed below)*. ***Leasing by banks or their subsidiaries:*** Section 6(1) of the BR Act does not expressly permit a bank to engage in aircraft leasing activities, and it is difficult to read 'aircraft ownership and leasing' into any of the activities listed under Section 6(1). In addition, Section 8 of the BR Act restricts a bank from (directly or indirectly) buying or selling or bartering in goods. However, under Section 6(1)(o) of the BR Act, the Central Government, may notify other permissible activities for a banking company. Further, the restriction on a bank buying/ selling/ holding assets under Section 8 does not apply to activities notified under Section 6(1) (o).	RBI/ Central Government (i.e. Ministry of Finance)	An aircraft can be construed as 'equipment', and 'equipment leasing' (which banks are permitted to undertake under the 1984 notification issued under Section 6(1)(o)) <u>can include the sale and lease back of aircrafts by banks</u>. A confirmation is required from the RBI to the effect that 'aircraft leasing' would be categorized as 'equipment leasing' for the purposes of Section 6(1)(o) of the BR Act and the Master Directions (Financial Services by Banks). Alternately, a notification may be requested from the Ministry of Finance under section 6(1)(o) of the BR Act to clarify that aircrafts qualify for equipment leasing activity to which the 1984 Notification applies.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
1.	***Banking Company***				
	However, with respect to such subsidiaries, the RBI, with the approval of the Indian Central Government, has the power (under Section 19(1)(c) of the BR Act), to identify other permissible activities on the grounds of 'public interest' or 'spread of banking in India'. Banks are restricted from holding more than 30% of the paid-up share capital of any kind of company, or 30% of its own paid up share capital or reserves (whichever is less) under Section 19(2) of the BR Act. However, this restriction does not apply to a banking company holding shares in its subsidiary.	… *(o) any other form of business which the Central Government may, by notification in the Official Gazette, specify as a form of business in which it is lawful for a banking company to engage.* …' (ii) Notification dated 14 August 1984 **(1984 Notification)** under Section 6(1)(o) of the BR Act: *'In exercise of the powers conferred by clause (o) of sub-section (1) of section 6 of the Banking Regulation Act, 1949 (10 of 1949), the Central Government hereby specifies 'equipment leasing' as a form of business in which it is lawful for a banking company to engage'* (iii) Master Directions (Financial Services by Banks) issued by the RBI provide directions to banks undertaking various financial services, including 'equipment leasing and hire purchase' undertaken through a subsidiary of the bank. (iv) BR Act: *Section 19 - Restriction on nature of subsidiary companies* *(1) A banking company shall not form any subsidiary company except a subsidiary company formed for one or more of the following purposes, namely: -* *(a) the undertaking of any business which, under clauses (a) to (o) of sub section (3) of section* *6, is permissible for a banking company to undertake, or* *(b) with the previous permission in writing of the Reserve Bank, the carrying on of the business of banking exclusively outside India, or* *(c) the undertaking of such other business, which the Reserve Bank may, with the prior approval of the Central Government, consider to be conducive to the spread of banking in India or to be otherwise useful or necessary in the public interest.*	In the year 1984, the Central Government notified 'equipment leasing and hire purchase' as a permitted activity under Section 6(1)(o) of the BR Act. For reference, the Central Government has also exercised its powers under Section 6(1)(o) to notify other permitted activities such as, factoring, insurance, investment advice, etc. The RBI Master Directions regulate such activities by banks or their subsidiaries. The term 'equipment' is not defined either under the Master Direction or the 6(1)(o) notification. There is no other guidance under the BR Act with respect to the ambit of the term 'equipment'. At the same time, the Indian Accounting Standard (Ind AS) 16 *(with respect to Property, Plant and Equipment)*, contains the following definition: *Property, plant and **equipment** are tangible items that: (a) are held for use in the production or supply of goods or services, **for rental to others**, or for administrative purposes; and (b) are expected to be used during more than one period.* Separately, the RBI, with the approval of the Central Government, has the power (under Section 19(1)(c) of the BR Act), to identify other permissible activities for a subsidiary of a bank on the grounds of 'public interest' or 'spread of banking in India'.		Separately, note that the Master Directions (Financial Services by Banks) provide that a subsidiary of a bank formed for the purposes of equipment leasing is required to comply with prudential regulation such as limits on investments (equity investment by a bank in a subsidiary company individually, shall not exceed 10% of the bank's paid-up share capital and reserves as per the last audited balance sheet or a subsequent balance sheet, whichever is lower) and prior RBI approval requirement for investment in certain specified entities. Another option would be to request for a specific notification to identify aircraft financing as a permissible activity on the grounds of 'public interest' or 'spread of banking in India'. The RBI has powers to issue such a notification pursuant to Section 19(1)(c) of the BR Act, with prior approval of the Central Government.

Key Takeaways:

(i) Confirmation by the RBI to the effect that aircraft is within the meaning of 'equipment' and aircraft leasing would qualify as equipment leasing activity permitted under the Master Directions (Financial Services by Banks) read with the 1984 Notification under Section 6(1)(o) of the BR Act.

(ii) The Central Government may specifically notify aircraft financing/ leasing as a permitted activity for banks under Section 6(1)(o) of the BR Act. Such notification is likely to be made by the Ministry of Finance after internal deliberations with the Ministry of Civil Aviation.

(iii) The RBI is authorized to issue a notification (with prior approval of the Central Government (in this case the Ministry of Finance)) under Section 19(1)(c) of the BR Act permitting aircraft financing/ leasing as an activity that can be undertaken by a subsidiary of a bank on account of it being useful or necessary in 'public interest' or 'spread of banking in India'.

We recommend approaching the RBI for a clarification under point (i) or a notification under point (ii).

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
1.	***Banking Company***				
	Restriction on Bank Activities in an IFSC 'Equipment leasing'/ 'aircraft financing' is not a permitted activity for a bank branch in IFSC.	(i) RBI circular - DBR.IBD.BC. 14570/23.13.004/2014-15 dated 1 April 2015 (ii) RBI circular - DBR.IBD.BC. 8536/23.13.004/2015-16 dated 7 January 2016 (iii) RBI circular -DBR.IBD.BC. 32/23.13.004/2016-17 dated 10 November 2016 (iv) FEMA IFSC Regulations	Banks having presence in India are permitted to establish branches in IFSC to carry out only specific banking activities, pursuant to the terms and conditions of, the RBI circular dated 1 April 2015 on Setting up of IFSC Banking Units **(IBU)** and the amendments thereto **(IBU Circular)**. The IBU Circular does not list equipment leasing or aircraft leasing as a permitted activity for banks. It also does not include investment by IBUs into equipment leasing entities as a permitted activity. However, the IBU Circular does not restrict an IBU from extending financing to equipment leasing or aircraft leasing companies located in IFSC.	RBI	***Leasing by banks/ subsidiaries:*** An amendment to the IBU Circular by the RBI is needed to permit IBU to undertake 'equipment leasing/ aircraft leasing' (and to clarify that such activity may be undertaken directly or through a subsidiary set up in IFSC).

Key Takeaways:

The RBI should be requested to amend the IBU Circular to permit IBUs in IFSC to (a) undertake equipment leasing either through a branch or a subsidiary, and (b) invest in the capital of an aircraft financing/ leasing entity established in IFSC (whether or not a subsidiary established by the bank branch).

Suggested language for notification:

- Confirmation by the RBI on the interpretation of the term 'equipment' under the Banking Regulation Act, 1949 and Master Directions – Reserve Bank of India (Financial Services provided by Banks) Directions, 2016"

"This has reference to the term 'equipment' in relation to the provisions of the Banking Regulation Act, 1949 and Master Directions – Reserve Bank of India (Financial Services provided by Banks) Directions, 2016. It is hereby clarified that 'aircraft' are covered within the meaning of the term 'equipment'."

- Notification under Section 6(1)(o) of the BR Act to be issued by the Ministry of Finance, Central Government to permit aircraft leasing/financing as a new permitted activity for banks:

"In exercise of the powers conferred by clause (o) of sub-section (1) of section 6 of the Banking Regulation Act, 1949 (10 of 1949), the Central Government hereby specifies 'equipment leasing' as a form of business in which it is lawful for a banking company to engage."

- Amendment by RBI to the circular on 'Setting up of IFSC Banking Units':

"Please refer to RBI circular DBR.IBD.BC.14570/23.13.004/2014-15 dated April 01, 2015, as modified from time to time, setting out RBI directions relating to IFSC Banking Units (IBUs).

A new paragraph No.2.6 (xiv) is added to the Annex I and II of the aforesaid circular dated April 1, 2015, which reads as under:

(xiv). IBUs are allowed to undertake equipment leasing and financing including sale and lease back of aircrafts, including investment in any entity set up in an IFSC carrying out such activity."

2.	***NBFCs***	
	Background: An NBFC is a company incorporated in India whose principal business activity includes the provision of loans and advances, acquisition of marketable securities, leasing, hire purchase, and insurance. An entity satisfies this 'principal business' test if: (a) its financial assets constitute more than 50 per cent of its total assets; and (b) its income from financial assets constitute more than 50 per cent of its gross income (as per their financial statements). Companies that meet these criteria are required to obtain registration as NBFCs from the RBI to continue to operations. The RBI regulates the operations of NBFCs in exercise of its powers under the RBI Act.	

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
2.	***NBFCs***				
	Treatment of 'aircraft leasing' activities undertaken by an NBFC (whether directly or through a subsidiary)	*RBI Act* *S. 45-I(c)* *"financial institution" means any non-banking institution which carries on as its business or part of its business any of the following activities, namely:– (i) the financing, whether by way of making loans or advances or otherwise, of any activity other than its own: (ii) the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature: (iii) letting or delivering of any goods to a hirer under a hire-purchase agreement as defined in clause (c) of section 2 of the Hire-Purchase Act, 1972: (iv) the carrying on of any class of insurance business; (v) managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or kuries as defined in any law which is for the time being in force in any State, or any business, which is similar thereto; (vi) collecting, for any purpose or under any scheme or arrangement by whatever name called, monies in lumpsum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person, <u>but does not include any institution, which carries on as its principal business,</u>– (a) agricultural operations; or (aa) <u>industrial activity</u>; or (b) the purchase or sale of any goods (other than securities) or the providing of any services; or (c) the purchase, construction or sale of immovable property, so however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons;* *<u>Explanation – For the purposes of this clause, "industrial activity" means any activity specified in sub-clauses (i) to (xviii) of clause (c) of section 2 of the Industrial Development Bank of India Act, 1964.'</u>*	***Leasing activity by NBFCs or its subsidiaries:*** By virtue of the exclusions under Section 45-I(c) of the RBI Act, an entity (set up by an airline operator or otherwise) which carries on as its principal business an 'industrial activity' is excluded from the definition of 'financial institution'. The term 'industrial activity' is defined with reference to the Industrial Development Bank Act, 1964 to include '*leasing, sub-leasing or giving on hire or hire purchase of industrial plants, equipments, machinery or other assets including vehicles, ships and aircraft.'* In view of the above, it is unclear whether an entity meeting the 50:50 test mentioned above whose <u>primary business</u> activity is aircraft leasing would qualify as an NBFC.	RBI	We would request a clarification from the RBI with respect to the applicability of this exception to aircraft financing/ leasing entities. It is pertinent to note that previously, 'Equipment Leasing' was expressly classified as an NBFC activity by the RBI, but this was later changed to the category of 'asset finance company'. At the same time, even the FDI policy contemplated "leasing & finance" as an NBFC permitted activity. We understand that various leasing entities have obtained registration as NBFCs with the RBI. As such, a clarification to the effect that entities undertaking aircraft leasing/ financing would themselves be NBFCs (financial lease or operating lease) and would be registered/ regulated as NBFCs with the RBI is required.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
2.	***NBFCs***				
		S. 45-I(f) *'non-banking financial company' means– (i) a financial institution which is a company; (ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner; (iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.'* Industrial Development Bank Act, 1964 *S.2(c)* *'industrial concern' means any concern engaged or to be engaged in,—* *. . .* *(xvi) leasing, sub-leasing or giving on hire or hire purchase of industrial plants, equipments, machinery or other assets including vehicles, ships and aircraft.'*			
Key Takeaways: *A confirmation from the RBI should be sought stating that equipment leasing/aircraft leasing entities would be eligible to register as NBFCs under Section 45-I(c) of the Reserve Bank of India Act, 1934.*					
	Restriction on NBFCs undertaking aircraft leasing/ financing	*RBI Act and RBI regulations for NBFCs*	***Financing by NBFCs:*** Unlike for banks, the RBI Act does not contain an exclusive list of activities for an NBFC. However, when defining NBFCs, the RBI Act recognizes that NBFCs engage in 'the financing, whether by way of making loans or advances or otherwise, of any activity other than its own.' The RBI Act does not restrict NBFCs from extending financing (debt finance) to an aircraft leasing entity (even if the aircraft leasing entity is sponsored by the NBFC). ***Leasing by NBFCs:*** Please see comments under the previous section above.		

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
2.	***NBFCs***				
	IFSC and NBFCs The RBI has not issued guidelines for NBFCs establishing branches/ subsidiaries in IFSC. Therefore, there is regulatory uncertainty.	*FEMA IFSC Regulations:* *2(b). 'Financial Institution' shall include:* • *a company, or* • *a firm, or* • *an association of persons or a body of individuals, whether incorporated or not, or* • *any artificial juridical person, not falling within any of the preceding categories engaged in rendering financial services or carrying out financial transactions.* *Explanation: For the purpose of this sub-regulation, and without any loss of generality of the above, the expression 'financial institution' shall include banks, non-banking financial companies, insurance companies, brokerage firms, merchant banks, investment banks, pension funds, mutual funds, trusts, exchanges, clearing houses, and any other entity that may be specified by the Government of India or a Financial Regulatory Authority.'*	FEMA IFSC Regulations recognize 'non-banking financial companies' as a category of companies that may set up operations in IFSC as a financial institution. Subject to the above mentioned clarification with respect to NBFC registration for an aircraft financing/ leasing entity (set up by an airline operator or otherwise) will most likely be an NBFC. Any aircraft financing entity set up in IFSC is likely to be a NBFC, by virtue of the 50:50 test. Unlike in the case of banks, the RBI has not issued corresponding directions enabling NBFCs to set-up shop (whether as a branch or a subsidiary) in IFSC.	RBI	There is a need for the RBI to issue regulations governing the establishment and operation of NBFCs in IFSC (this is a larger issue and not limited to aircraft financing alone). The RBI currently has in place regulations for the establishment of offshore branches/ subsidiaries/ joint ventures by an NBFC. The RBI could look to extend these regulations with suitable modifications to operations of NBFCs in IFSC. In the alternate the RBI may even issue regulations solely for establishment and operation of aircraft financing/ leasing entities in IFSC (instead of a broader framework for all NBFCs). Further the RBI may allow ordinary NBFC operations to invest/ finance aircraft leasing entities. RBI to notify guidelines for setting up NBFC in IFSC and also clarify that NBFC can aircraft financing/ leasing activities in IFSC.

Key Takeaways:

The RBI should be requested to issue regulations for the establishment of NBFCs in IFSC, or at the very least for NBFCs undertaking aircraft financing/leasing services in IFSC (similar to the IBU Circular issued for banks).

RBI to provide:

Amendments to the existing Non-Banking Financial Companies (Opening of Branch/Subsidiary/Joint Venture/ Representative Office or Undertaking Investment Abroad by NBFCs) Directions, 2011 to provide for a framework for setting up NBFCs in IFSC;

OR

New regulations providing for the operation of aircraft financing/ leasing NBFCs in IFSC to be issued by the RBI.

Further, the framework to be provided by the RBI for setting up NBFCs in IFSCs should inter alia address the following:

(a) Banks/ other entities in India should be permitted to establish NBFCs in IFSC if they meet the financial income test under S.45(I)(c) of the RBI Act;

(b) NBFCs in India should be permitted to establish subsidiary/ joint venture/affiliate in IFSC or undertake investment in IFSC;

(c) For existing registered NBFCs, no objection certificate route should not be required and they should be automatically grandfathered into IFSC as long as such an NBFC in India is eligible as per extant norms to set up abroad (refer to notification no. DNBS.(PD)229 / CGM(US)-2011 dated June 14, 2011);

(d) NBFCs established in IFSC should be allowed to undertake aircraft financing/ leasing activities (whether financial lease or operating lease);

(e) The restriction on multi-layered and cross-jurisdictional structures under the NBFC Directions should not be applicable to NBFC operations in IFSC (refer to notification no. DNBS.(PD)229 / CGM(US)-2011 dated June 14, 2011);

(f) The requirement for the NBFC to be profit earning for the immediately preceding 3 years before being eligible to set -up overseas entities, should not apply to NBFCs proposing to set up in IFSCs (refer to notification no. DNBS.(PD)229 / CGM(US)-2011 dated June 14, 2011);

(g) Prudential norms applicable to the NBFCs established in IFSC (capital adequacy, concentration norms, etc.) can be relaxed as compared to norms applicable in the domestic tariff area (approach should be to compare against prudential norms followed in international IFSCs established in other jurisdictions);

(h) There should be no restriction on NBFCs in IFSCs undertaking leasing transactions with entities in the domestic tariff area.

(I) Regulation of NBFC IFSC entities should be separate from NBFCs in India –

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
2.	***NBFCs***				
• *Disclosure requirements to regulator at IFSC should be at par with disclosure requirements sought internationally;* • *Sectors in which outlay of funds should be allowed by NBFC IFSC including limits that would apply to extend line of credit including infrastructure, leasing (equipment, aircrafts, etc.), asset reconstruction, capital market – margin funding, etc., housing refinancing, factoring and bill discounting, etc.;* • *Source of funds allowed - Such an IFSC entity of a NBFC should be allowed to be used as a vehicle which should be allowed to raise finance as a leasing company for operations of airlines located in India and foreign airlines. Loans against shares, securities listed at IFSC or liquid securities listed in recognized global exchanges should be allowed as collateral to extend credit.*					
3.	***AIF***				
Background: • An AIF is a privately pooled investment fund incorporated in the form of a trust or a LLP or a company and registered as such with the SEBI. While there are multiple categories of AIFs, a Category II AIF (i.e. a private equity fund or a debt fund) that invests primarily in unlisted investee companies according to the stated investment objective of the fund, is most relevant in this context. • In this case, AIF would fund the entity undertaking the aircraft leasing/ financing activity, and would not undertake leasing activities itself. However, we have considered two scenarios, (i) a Category II AIF located in the DTA (i.e. outside the IFSC) financing a leasing company located in the IFSC; and (ii) a Category II AIF located in the IFSC financing a leasing company in IFSC. • The AIF route is one of the most efficient routes for HNIs to participate in this space. Both person resident outside India and resident in India are permitted to invest in AIFs. • An AIF is set up by a 'sponsor' and the investments are managed by its 'manager' (who can be same as the sponsor). There are 'fit and proper' criteria for both the sponsor and the manager.					
	Cap on Investments	Regulation 15(1)(c) of the SEBI (AIF) Regulations prescribes that Category II AIF shall invest not more than 25% of the investable funds in one Investee Company.	Category II AIFs are not allowed to invest more than 25% of the corpus (i.e. the total amount of funds committed by investors), after deducting estimated expenditure for administration and management of the fund, in one investee company.	SEBI	The most straightforward way of addressing this issue is for SEBI to create a separate category of AIFs (under the existing SEBI AIF regulations) targeting investments in aircraft leasing companies. There is precedent for this: SEBI amended the AIF Regulations in 2013 to include Angel Funds (in Chapter III-A of the SEBI (AIF) Regulations). Alternatively, SEBI could introduce amendments to the existing framework for category II AIFs, permitting greater exposure to target companies that are aircraft leasing companies.
Key Takeaways: *SEBI should be requested to amend the AIF Regulations to create a separate category of AIFs for investments in aircraft leasing companies or amend the existing regulatory framework of Category-II AIFs to permit greater concentration of investments in entities engaged in aircraft financing/ leasing.*					

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
3.	***AIF***				
	IFSC Considerations	Clause 22(1) of the SEBI (IFSC) Guidelines prescribes that an AIF operating in an IFSC can accept investments from the following categories of investors: (i) person resident outside India (ii) non-resident Indian (iii) institutional investor resident in India eligible under foreign exchange laws to invest funds offshore (to the extent permitted) (iv) person resident in India having a net worth of at least USD 1 million, to the extent allowed in the Liberalized Remittance Scheme i.e. maximum of USD 250,000. Clause 22(3) of the SEBI (IFSC) Guidelines deals with the type of securities in which any AIF operating in an IFSC can invest. An AIF operating in IFSC is permitted to invest only in securities which are listed in IFSC or issued by companies incorporated in IFSC or issued by companies belonging to foreign jurisdiction.	• Unlike in the case of NBFCs, the SEBI Guidelines clearly permit the establishment and operation of AIFs in IFSC. • Current exchange control laws contain limitations on foreign investments by entities in India (as identified under the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004). For instance, a listed Indian company can invest in shares of a listed overseas entity, SEBI registered mutual funds may invest in shares on the rated bonds/ fixed income securities of a listed overseas company within the specified limits, an Indian party engaged in financial services sector may make investments outside India subject to fulfilment of certain conditions, etc. Presumably, though not clear they would be the institutional investors referred in the said Clause 22 (1) (ii). Eligible resident individuals are permitted to invest upto USD 250,000 per annum into an overseas AIF. However, this USD 250,000 is a composite limit for most other overseas remittances by resident individuals. These limits restrict the ability of AIFs located in IFSC to raise funds from domestic HNIs, and consequently their participation in aircraft financing.	SEBI and RBI	It is unclear which categories of investors (as identified under the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004) would be permitted to invest in IFSC AIFs, given that the term 'institutional investors' is not defined under the SEBI guidelines or the said foreign exchange regulations. It would be necessary to obtain a separate clarification from SEBI and RBI on this. Given the limitation on domestic investors investing into an AIF based out of IFSC as described above, the RBI should further liberalize the options for Indian HNIs to invest in AIF targeting aircraft leasing in IFSC.

<table>
<tr><th>S. NO.</th><th>ISSUE</th><th>LEGISLATION CONCERNED</th><th>LEGAL CONSIDERATIONS</th><th>AUTHORITY CONCERNED</th><th>COMMENTS</th></tr>
<tr><td>3.</td><td colspan="5">AIF</td></tr>
<tr><td colspan="6">Key Takeaways:
(i) RBI and SEBI should be requested to provide clarification on types of institutional investors contemplated under the SEBI (International Financial Services Centre) Guidelines, 2015;
"This is with reference to SEBI (International Financial Services Centers) Guidelines, 2015 which prescribe Categories of investors that can invest in an AIF operating out of IFSC. It is hereby clarified that the following classes of investors (including without limitation) are considered institutional investors:
(a) Banks;
(b) NBFCs;
(c) AIFs;
(d) Pension Funds;
(e) Insurance Companies;
(f) Hedge Funds; and
(g) Any other financial institution."
(ii) RBI should be requested to provide additional relaxation under the Liberalised Remittance Scheme for Indian residents to invest in AIF operating in an IFSC.
"Under the Liberalised Remittance Scheme, Authorised Dealers may freely allow remittances by resident individuals up to USD [●] per Financial Year (April-March) for any current or capital account transaction or a combination of both made in any entity undertaking aircraft leasing/ financing in IFSC."</td></tr>
<tr><td></td><td>Investment by a domestic AIF into a Leasing Company operating in IFSC</td><td>Clause 2(B) of the SEBI Circular dated October 1, 2015 prescribes the guidelines on overseas investments and other issues/clarifications for AIFs.</td><td>A domestic AIF is permitted, subject to prior approval from SEBI, to invest up to 25% of its investible funds of each scheme in equity and equity linked instruments of offshore venture capital undertakings (i.e. overseas unlisted entities). There is an overall cap of USD 750 million on overseas investments by all AIFs in India, which is available on a first come-first serve basis.

Also, foreign exchange regulations, with respect to overseas investments by domestic AIFs do not clearly permit AIFs to invest in overseas debt instruments (whether listed or unlisted).

Lastly, HNIs would have flexibility to invest greater funds into domestic AIFs (as compared to AIFs located in IFSC), by virtue of the above USD 250,000 restriction.</td><td>SEBI and RBI</td><td>With respect to domestic AIFs investing into an aircraft leasing entity located in IFSC, specific clarifications from RBI and SEBI would be necessary i.e. whether such investments are regarded as domestic investments or overseas investments in offshore venture capital undertakings. In addition, SEBI and RBI should offer additional relaxations (including relaxation of this 25% cap) on AIFs targeting investments in aircraft leasing entities located in IFSC.

RBI (under FEM (Transfer or Issue of any Foreign Security) Regulations, 2004) to provide relaxation to the overall cap of USD 750 million or specify non-applicability of the overall cap (in respect of overseas investments by all AIFs in targeting investments India) for AIFs in entities engaged in aircraft financing/ leasing out of IFSC.

RBI to amend FEM (Transfer or Issue of Any Foreign Security) Regulations, 2004 to permit investments by AIFs in debt instruments (whether listed or unlisted) issued by aircraft leasing entities in IFSC.</td></tr>
</table>

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
3.	***AIF***				

Key Takeaways:

(i) SEBI to clarify under SEBI Circular dated October 1, 2015 and RBI to clarify under FEM (Transfer or Issue of Foreign Security) Regulations, 2004, the position on investment by AIFs in IFSC (whether such investment is domestic or offshore);

(ii) RBI (under FEMA (Transfer or Issue of any Foreign Security) Regulations, 2004) to provide relaxation to the overall cap of USD 750 million or specify non-applicability of the overall cap (in respect of overseas investments by all AIFs in India) for AIFs targeting investments in entities engaged in aircraft financing/ leasing out of IFSC.

Suggested amendment language:
"This has reference to circular dated July 3, 2018 which had allowed overseas investments by AIFs to the extent USD 750 million. In consultation with the RBI it is now decided to exempt AIFs investing in entities engaged in aircraft financing/ leasing operating out of IFSC from the overall cap of USD 750 million."

(iii) RBI to amend FEM (Transfer or Issue of Any Foreign Security) Regulations, 2004 to permit investments by AIFs in debt instruments (whether listed or unlisted) issued by aircraft leasing/ financing set up in IFSC.

Suggested amendment language:
"This has reference to circular dated October 1, 2015 which restricted investments by AIFs in debt instruments. In consultation with the RBI it is now decided to permit investments by AIFs in debt instruments (whether listed or unlisted) issued by aircraft financing/ leasing entities in IFSC."

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
4.	***Pension Funds***				
	Investment by Pension Funds The National Pension System **(NPS)** is a national contributory pension fund system available for subscription to all Indian citizens (including non-resident Indians) which is regulated by the Pension Fund Regulatory and Development Authority **(PFRDA)** under the PFRDA Act, 2013. NPS is managed and operated by pension fund managers knows as pension funds. The subscribers to NPS may choose from multiple pension funds and multiple schemes. The pension fund manages schemes notified by the PFRDA in accordance with norms of management of corpus of pension fund, including investment guidelines as approved by the PFRDA from time to time.	Section 25 of the PFRDA Act, 2013: No pension fund shall, directly or indirectly invest outside India, the funds of subscribers. Circular No. PFRDA/2017/18/PF/2 dated May 04, 2017 (Investment Guidelines for National Pension Scheme (NPS)): The investments in AIF Category I and AIF Category II is allowed subject to satisfaction of the following conditions: (I) The permitted funds under category I are Infrastructure Funds, SME Funds, Venture Capital Funds and social venture capital funds as detailed in Alternative Investment Funds Regulations, 2012 by SEBI. (ii) For category II-AIF as per Alternative Investment Funds Regulations, 2012 by SEBI, at least 51% of the funds of such AIF shall be invested in either of the infrastructure entities or SMEs or venture capital or social welfare entities. (iii) Pension Fund shall only invest only in those AIFs whose corpus is equal to or more than Rs. 100 crore. (iv) The exposure to a single AIF shall not exceed 10% of the AIF size. Investments under this category shall only be in listed instruments or fresh issues that are proposed to be listed.	Pension funds cannot invest in the equity of entities. Pension funds are not permitted to invest funds of subscribers outside India either directly or indirectly. However, it is unclear whether this restriction would also apply to investment by pension funds into (a) leasing entities established in IFSC, or (b) domestic Category-II AIFs which in turn provide finance to leasing entities established in IFSC.	PFRDA	PFRDA may be requested to clarify whether the restriction on pension funds to invest funds of policyholders outside India (either directly or indirectly) would apply to investments by pension funds money into entities established in IFSC or in domestic Category-II AIFs that are in turn investing in aircraft financing/ leasing entities located in IFSC. PFRDA may permit pension funds to invest in equity or debt of companies.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
4.	***Pension Funds***				
		In case the scheme corpus reaches INR 1 crore: NPS investment have been restricted to 5% of the 'paid-up equity capital' of all the sponsor group companies or 5% of the total Assets Under Management (AUM) under Equity exposure whichever is lower, in each respective scheme and 10% in the paid up equity capital of all the non-sponsor group companies or 10% of the total AUM under Equity exposure whichever is lower, in each respective scheme. Here, the paid-up share capital means market value of paid up and subscribed equity capital.			
Key Takeaways: *(i) PFRDA to clarify under the PFRDA Act that pension funds are permitted to invest into domestic AIFs, even if they may use funds for investments into aircraft financing/ leasing entities located in IFSC, or that investment into IFSC entities would not be considered as overseas investment by pension funds.* *Suggested amendment language:* *"With reference to Section 25 of the PFRDA Act, 2013 in relation to restrictions on investment by insurers (either directly or indirectly) outside India, it clarified that investment by insurers of funds of subscribers in entities established in IFSC [or in domestic Category-II Alternate Investment Funds established for investments in or financing of entities set up in IFSCs] shall not be considered as overseas investment."* *(ii) PFRDA to amend the investment guidelines to allow pension funds to invest in equity or debt instruments of companies.* *Suggested amendment language:* *"With reference to Investment Guidelines for NPS dated May 4, 2017, it is hereby clarified that pension funds are permitted to invest in equity or debt instruments of both private or public companies that are established in IFSCs"*					
5.	***Insurance Companies***				
	Background: Insurers in India are permitted to invest only a certain portion of their assets or controlled funds, as described under the Insurance Act and the Insurance Regulations framed thereunder, in various categories of investment as prescribed by the IRDAI. This has been analysed in the context of insurance companies funding entities undertaking aircraft financing/ leasing. Separately, note that there are no restrictions on insurance companies to insure the aircrafts that may be owned by the aircraft leasing company availing financing from such insurance companies.				
	Restrictions on investments *Under Section 27A(4) of the Insurance Act, insurance companies are not permitted to invest in private limited companies.* *This restriction is replicated under the Insurance Regulations.*	Section 27A(4) of the Insurance Act: *An insurer shall not out of his controlled fund or assets as referred to in sub-section (2) of section 27 invest or keep invested in the shares or debentures of any private limited company.* Section 2CA: *The Central Government may, by notification, direct that any of the provisions of this Act –*	The restriction under Section 27A(4) is a blanket restriction and neither the IRDAI nor the Central Government is empowered to relax this through regulatory or executive action. Therefore, a relaxation of this restriction would require a legislative amendment. However, under Section 2CA, the Central Government has the power to relax the restriction for insurers in an SEZ. GIFT City IFSC is an SEZ.	IRDAI	The Central Government, in exercise of its powers under Section 2CA, should relax the provision of Section 27A(4) with respect to investments by insurers in IFSC into aircraft leasing entities in GIFT City.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
5.	***Insurance Companies***				
		(a) shall not apply to insurer, being an Indian Insurance Company, insurance co-operative society or a body corporate referred to in clause (c) of sub-section (1) of section 2C, carrying on the business of insurance, in any Special Economic Zone as defined in clause (za) of section 2 of the Special Economic Zones Act, 2005; or *(b) shall apply to any insurer, being an Indian Insurance Company, insurance co-operative society or a body corporate referred to in clause (c) of sub-section (1) of section 2C, carrying on the business of insurance, in any Special Economic Zone as defined in clause (za) of section 2 of the Special Economic Zones Act, 2005 only with such exceptions, modifications and adaptations as may be specified in the notification.*			
	Categories of investments *The Insurance Act read with the associated Insurance Regulations contains an exhaustive list of investments that an insurance company is permitted to make. This exhaustive list does not accommodate investments into aircraft leasing companies (of the type being considered here).*	Insurance Regulations Regulation 13F: *Every Insurer shall invest its controlled fund as defined under Section 27A / all assets as defined under Section 27(2) of the Insurance Act 1938 as amended from time to time, only within the exhaustive category of investments listed in the guidelines issued by the Authority.*	The exhaustive list prescribed by the IRDAI will have to be amended by the IRDAI to include equity/ debt of aircraft leasing companies of the type being considered here. Currently, only the following items under the exhaustive list come close to our current requirements, but do not offer a viable solution: • Corporate Securities-Equity Shares (Ordinary)-Quoted • Corporate Securities-Bonds- (Taxable) • Corporate Securities-Preference Shares • Corporate Securities-Investment in Subsidiaries • Corporate Securities-Debentures • Preference Shares • Short term Loans (Unsecured Deposits) • Term Loans (without Charge)	IRDAI	With the Section 2CA relaxation, the IRDAI would need to issue an amendment to these Insurance Regulations to relax investments in equity and listed debt securities, and permit investment in unlisted debt securities of private companies undertaking aircraft leasing entities in IFSC.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
5.	***Insurance Companies***				

Key Takeaways:

(i) The Ministry of Finance, Central Government to issue notification under Section 2CA of the Insurance Act, 1938 to exempt insurance companies in IFSC from the investment restriction provisions under Section 27A(4) of the Insurance Act, 1938.

Suggested amendment language:
"In exercise of the powers conferred by section 2CA of the Insurance Act, 1938 (4 of 1938), the Central Government hereby directs that the provisions contained in section 27A(4) of the Insurance Act shall not apply to investments by insurers in [aircraft financing/ leasing entities] established in an IFSC."

(ii) Consequent amendments to the list of permitted investments under the IRDAI (Investment) Regulations, 2016, to relax investment by insurers in equity and listed debt securities, and permit investment in unlisted debt securities of private companies undertaking aircraft leasing.

Suggested amendment language:
"Provided that an insurer is permitted to invest in equity and listed debt securities, and unlisted debt securities of private companies undertaking aircraft leasing/ financing in IFSC."

	Restrictions on business of IIO IIOs (i.e. branches) of insurance companies operating out of IFSC are not permitted to undertake any business other than those permitted by the IRDAI.	*IRDAI (Registration and Operations of IIO) Guidelines, 2017* *Guideline 6* *The sole object of the IIO, on being registered with the Authority, shall be to exclusively carry on insurance or reinsurance business from an IFSC. An IIO shall not engage itself in any business other than those permitted by the Authority.*	It is unclear from the wording of this restriction whether investment activities permitted by the IRDAI (as described above) would be included under the activities permitted for IIOs. In order for IIOs to participate effectively in aircraft leasing/ financing through an entity established for that purpose, the IRDAI must issue a separate notification/ circular permitting the IIO to invest in such entities.	IRDAI	IRDAI to amend the IRDAI (Registration and Operations of IIO) Guidelines, 2017 to permit insurance companies set up in IFSC to invest in entities engaged in aircraft financing/ leasing.

Key Takeaways:

The IRDAI to amend the IRDAI (Registration and Operations of IIO) Guidelines, 2017 by permitting insurance companies set up in IFSC to invest in entities engaged in aircraft financing/ leasing in an IFSC.

Suggested amendment language:

IRDAI to add a proviso to Guideline 6(b) of the IRDAI (Registration and Operations of International Financial Service Centre Insurance Offices (IIO)) Guidelines, 2017:

"(b) The sole object of the IIO, on being registered with the Authority, shall be to exclusively carry on insurance or reinsurance business from an IFSC. An IIO shall not engage in any business other than those permitted by the Authority.

Provided that the IIO may be permitted to invest in entities engaged in aircraft financing/ leasing."

	Prohibition on investment of funds abroad Under Section 27E of the Insurance Act, insurance companies are not permitted to invest funds of policyholders outside India either directly or indirectly.	*(i) Insurance Act:* *S 27E* *No insurer shall directly or indirectly invest outside India the funds of the policyholders.* *(ii) Master Direction on Insurance issued by the RBI* *Direction 4.7* *Insurer in India may invest freely, out of their funds abroad without prior approval of the RBI subject to,* *(i) statutory requirement of any host country concerned, and,* *(ii) IRDAI guidelines if any and in accordance with applicable FEMA regulations relating to investment abroad.*	It is unclear from the wording of Section 27E whether it would apply to investment by an insurance company into aircraft leasing companies established in IFSC. It is necessary to obtain a clarification from the IRDAI that this restriction would not apply to investments into aircraft leasing entities in IFSC (whether or not through the IIO).	IRDAI	Clarification from IRDAI under the Insurance Act that investment of policyholders' funds into IFSC will not be regarded as overseas investments. Alternately, the Ministry of Finance may notify under S.2CA of the Insurance Act that insurance companies in IFSC are exempted from the restriction on overseas investment.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
5.	***Insurance Companies***				
			It is to be noted in this context that insurance companies in India are permitted to invest freely, out of their funds abroad (not domestic policyholder money) without prior approval of the RBI subject to (i) statutory requirement of any host country concerned, and, (ii) IRDAI guidelines if any and in accordance with applicable FEMA regulations relating to investment abroad. It is unclear if this provision would apply to investments by insurers into aircraft financing/ leasing entities through the IIOs using its funds outside India.		

Key Takeaways:

(i) Clarification from IRDAI under the Insurance Act that investment of policyholders' funds into IFSC will not be regarded as overseas investments.

Alternately, the Ministry of Finance may notify under S.2CA of the Insurance Act that insurance companies in IFSC are exempted from the restriction on overseas investment.

Suggested amendment language:
"It is hereby clarified that investments by insurers into IFSC shall not be regarded as overseas investments."
OR
"In exercise of the powers conferred by section 2CA of the Insurance Act, 1938 (4 of 1938), the Central Government hereby directs that the provisions contained in section 27E of the Insurance Act shall not apply to investments by insurer into aircraft financing/ leasing entities in an IFSC."

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
6.	***Mutual Funds***				
	Cap on Investments	*Schedule VII of SEBI (Mutual Funds) Regulations, 1996 prescribes restrictions on investments by mutual funds:* *1. A mutual fund scheme shall not invest more than 10% of its NAV in debt instruments comprising money market instruments and non-money market instruments issued by a single issuer which are rated not below investment grade by a credit rating agency authorised to carry out such activity under the Act. Such investment limit may be extended to 12% of the NAV of the scheme with the prior approval of the Board of Trustees and Board of Directors of the asset management company.* *1A. A mutual fund scheme shall not invest more than 10% of its NAV in unrated debt instruments issued by a single issuer and the total investment in such instruments shall not exceed 25% of the NAV of the scheme. All such investments shall be made with the prior approval of the Board of Trustees and the Board of asset management company.* *11. A mutual fund scheme shall not invest more than 5% of its NAV in the unlisted equity shares or equity related instruments in case of open ended scheme and 10% of its NAV in case of close ended scheme.*	Mutual funds are not allowed to invest more than 10%-12% of its NAV in rated debt instruments, 10%-25% of their NAV in unrated debt instruments and 5%-10% of their NAV in unlisted equities.	SEBI	The most straightforward way of addressing this issue is for SEBI to create a separate category of mutual funds (under the existing SEBI regulations) targeting investments in aircraft leasing companies. Alternatively, SEBI could introduce amendments to the existing framework for mutual funds, permitting greater exposure to target companies that are aircraft leasing companies.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
6.	***Mutual Funds***				
	Scope of overseas investments	*As per the A. P. (DIR Series) Circular No.12 dated September 26 2007 - Overseas Investment by Mutual Funds – Liberalization:* *Mutual Funds not permitted to invest in unlisted equity/equity linked instruments of foreign companies.* *Further, mutual funds are permitted to invest in foreign debt securities in the countries with fully convertible currencies, short term as well as long term debt instruments with rating not below investment grade by accredited / registered credit rating agencies.*	Mutual Funds are not permitted to invest in overseas unlisted equity/equity linked instruments and foreign debt instruments.	RBI	RBI to amend FEM (Transfer or issue of any Foreign Security outside India) Regulations, 2004 to permit investments by mutual funds in unlisted equity/ equity linked instruments, and foreign debt instruments issued by entities engaged in aircraft leasing set up in IFSC.
	IFSC Considerations	Clause 22(1) of the SEBI (IFSC) Guidelines prescribes that a mutual fund operating in an IFSC can accept investments from the following categories of investors: *(i) person resident outside India* *(ii) non-resident Indian* *(iii) institutional investor resident in India eligible under foreign exchange laws to invest funds offshore (to the extent permitted)* *(iv) person resident in India having a net worth of at least USD 1 million, to the extent allowed in the Liberalized Remittance Scheme i.e. maximum of USD 250,000.* Clause 22(3) of the SEBI (IFSC) Guidelines deals with the type of securities in which any mutual fund operating in an IFSC can invest. A mutual fund operating in IFSC is permitted to invest only in securities which are listed in IFSC or issued by companies incorporated in IFSC or issued by companies belonging to foreign jurisdiction. Clause 22(4): *An asset management company of a mutual fund operating in IFSC shall have a net worth of not less than USD 2 million which shall be increased to USD 10 million within 3 years of commencement of business in IFSC.*	Current exchange control laws contain limitations on foreign investments by entities in India (as identified under the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004). Eligible resident individuals are permitted to invest upto USD 250,000 per annum into an overseas mutual fund. However, this USD 250,000 is a composite limit for most other overseas remittances by resident individuals. These limits restrict the ability of mutual funds located in IFSC to raise funds from domestic HNIs, and consequently their participation in aircraft financing.	SEBI and RBI	It is unclear which categories of investors (as identified under the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004) would be permitted to invest in IFSC mutual funds, given that the term 'institutional investors' is not defined under the SEBI guidelines or the said foreign exchange regulations. It would be necessary to obtain a separate clarification from SEBI and RBI on this. Given the limitation on domestic investors investing into an mutual funds based out of IFSC as described above, the RBI should further liberalize the options for Indian HNIs to invest in mutual funds targeting aircraft leasing in IFSC.

Key Takeaways:

(i) Amendment of the SEBI (Mutual Funds) Regulations, 1996 to create a separate category of mutual funds for investments in aircraft leasing companies OR to permit greater concentration of investments in entities engaged in aircraft financing/ leasing in an IFSC.

(ii) RBI to amend FEMA (Transfer or issue of any Foreign Security outside India) Regulations, 2004 to permit investments by mutual funds in unlisted equity/equity linked instruments, and foreign debt instruments issued by entities engaged in aircraft leasing set up in IFSC.

(iii) SEBI to provide clarification on types of institutional investors contemplated under the SEBI (International Financial Services Centre) Guidelines, 2015.

(iv) RBI to provide additional relaxation under the Liberalised Remittance Scheme for Indian residents to invest in mutual funds operating in an IFSC.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
6.	***Mutual Funds***				

Key Takeaways:

Suggested amendment language:

1. RBI to issue circular under Regulation 26 of Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 stating:

"This has reference to circular dated September 26, 2007 which restricted investments by mutual funds in unlisted equity/ equity related instruments or debt instruments of foreign companies. It is now decided to permit investments by mutual funds in unlisted equity/ equity linked instruments, and debt instruments issued by entities engaged in aircraft leasing set up in IFSC."

2. SEBI to clarify the meaning of 'institutional investors' (after consultations with RBI) and include the following categories of investors:

(a) Banks;
(b) NBFCs;
(c) AIFs;
(d) Pension Funds;
(e) Insurance Companies;
(f) Hedge Funds;
(g) Any other financial institution.

3. RBI to amend the Master Direction - Liberalized Remittance Scheme (LRS) and add a new paragraph No.1A to the master directions stating:

"Under the Liberalised Remittance Scheme, Authorised Dealers may freely allow remittances by resident individuals up to USD [] per Financial Year (April-March) for any current or capital account transaction or a combination of both made in any entity undertaking aircraft leasing/ financing in IFSC."

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
7.	***Employees Provident Fund Organization (EPFO)***				
	Restrictions on investment by Employees Provident Fund Organization (EPFO)	Notification S.O. 1071(E) dated April 23, 2015 by Ministry of Labour and Employment enlists the permitted investments of the accretions belonging to the provident fund, which does not include investments in private companies or AIFs.	The EPFO is not permitted to be invest provident funds in companies or in domestic AIFs.	Central Government i.e. Ministry of Labour and Employment	The Central government (through Ministry of Labour and Employment) to issue a notification to allow EPFO to invest in entities engaged in aircraft financing/ leasing in an IFSC or in domestic AIFs.

Key Takeaways:

The Central government (through Ministry of Labour and Employment) to issue a notification to permit investments in companies engaged in aircraft financing/leasing set up in IFSC, and in AIFs.

Suggested amendment language:
"This is with reference to notification dated 23 April, 2015 which prohibits investments by the Employees Provident Fund Organization (EPFO) in private companies or domestic Alternate Investment Funds. It has now been decided to permit the EPFO to make investments in entities engaged in aircraft financing/ leasing in IFSC or in domestic Alternate Investment Funds."

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
8.	***Foreign Lenders - ECBs under Automatic Route (for PDP financing)***				
(I)	***Minimum Average Maturity Period*** For all ECBs under the automatic route the RBI Master Directions – ECBs, Trade Credit, Borrowing and Lending in Foreign Currency by Authorized Dealers and Persons other than Authorized Dealers **(ECB Master Directions)** prescribe a minimum maturity period.	Under the ECB Master Directions, the following minimum average maturity periods are prescribed: Automatic Route – Track 1: a) 3 years for ECB up to USD 50 million or its equivalent. b) 5 years for ECB beyond USD 50 million or its equivalent. Automatic Route – Track 2: a) 10 years irrespective of the amount. Automatic Route – Track 3: a) Same as under Track 1.	These minimum average maturity stipulations restrict the use of the automatic ECB route for PDP Financing. If the terms of the financing documentation are lesser than the prescribed minimum average maturity period, prior RBI approval is required.	RBI	RBI, in its capacity of foreign exchange regulator, can issue specific directions under Section 11 of Foreign Exchange Management Act, 1999 **(FEMA Act)** to provide specific exception/ relaxation for Indian airline companies from these minimum maturity requirements and monetary restrictions.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
8.	***Foreign Lenders - ECBs under Automatic Route (for PDP financing)***				
(I)		Paragraph 2.4.6 of the ECB Master Directions set out individual limits with respect to the amount of ECB which can be raised in a financial year under the automatic route: i. The individual limits of ECB that can be raised by eligible entities under the automatic route per financial year for all the three tracks are set out as under: a. *Up to USD 750 million or equivalent for the companies in infrastructure and manufacturing sectors, Non-Banking Financial Companies - Infrastructure Finance Companies (NBFC-IFCs), NBFCs-Asset Finance Companies (NBFC-AFCs), Holding Companies and Core Investment Companies;* b. *Up to USD 200 million or equivalent for companies in software development sector;* c. *Up to USD 100 million or equivalent for entities engaged in micro finance activities; and* d. *Up to USD 500 million or equivalent for remaining entities.*			
(ii)	***Recognized lenders/ investors*** For each of the three tracks, the ECB Master Directions list out the recognized lenders/ investors for the three tracks.	The ECB Master Directions prescribe the following categories of recognized lenders under Track I: *(I) International banks* *(ii) International capital markets* *(iii) Multilateral financial institutions (such as, IFC, ADB, etc.) / regional financial institutions and Government owned (either wholly or partially) financial institutions* *(iv) Export credit agencies* *(v) Suppliers of equipment* *(vi) Foreign equity holders* *(vii) Overseas long-term investors such as:* *a) Prudentially regulated financial entities;* *b) Pension funds;* *c) Insurance companies;* *d) Sovereign Wealth Funds;* *e) Financial institutions located in International Financial Services Centres in India* *(viii) Overseas branches / subsidiaries of Indian banks.* Each of the above entities are also eligible lenders under Tracks 2 and 3 (except for overseas branches of Indian banks). In addition, Track 3 also includes overseas organizations and individuals as eligible lenders.		RBI	Given the restricted list of recognized lenders, the lender for the PDP Financing cannot be an entity that does not fall under one of the items on the list. Leasing entities should qualify as eligible lenders after they are recognized as 'financial institutions' in IFSC (by virtue of being NBFCs) and regulated as such.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
8.	***Foreign Lenders - ECBs under Automatic Route (for PDP financing)***				
(iii)	***All-in-Cost Requirements***	With respect to Track 1 and Track 2, the 'all in cost ceiling' (i.e., the maximum cost that the Indian borrower is permitted to incur on the facility, including interest, redemption premium, fees, charges and expenses) is *450 basis points per annum over 6 month USD LIBOR (or applicable benchmark for respective currency).* The 'all in cost ceiling' for Track 3 *is 450 basis points over the benchmark rate. The benchmark rate will be the prevailing yield of the Government of India securities of corresponding maturity for Track III (Rupee ECBs) and Rupee Denominated Bonds.*	The 'all in cost ceiling' caps the returns for the lender on financing through this route.	RBI	RBI can issue specific directions under Section 11 of FEMA Act to relax the 'all in cost ceiling' for airlines seeking to access this route for PDP Financing.
(iv)	***Permitted End-use by Indian airline companies***	The ECB Master Directions prescribe airline companies as eligible borrowers under Track I. The borrowers can raise loan for any end-use (except for the activities expressly provided in the negative list). The negative list is as follows: *a) Investment in real estate or purchase of land except when used for affordable housing as defined in Harmonised Master List of Infrastructure sub-sectors notified by Government of India, construction and development of SEZ and industrial parks/integrated townships.* *b) Investment in capital market.* *c) Equity investment.* *For Track I and Track III, the following items are also on the negative list (except when raised from direct and indirect equity holders or from a group company, and provided the loan is for a minimum average maturity of 5 years):* *d) Working capital purposes* *e) General corporate purposes* *f) Repayment of Rupee loans* *g) On-lending to entities for the above activities from (a) to (f).*	The permitted end-use in the ECB Master Directions state that Indian airline companies cannot raise ECBs for working capital purposes or for general corporate purposes under Track I and Track III. A notification to the effect that *pre delivery payments* are not covered under the term 'general corporate purposes' is required for abundant clarity to allow airlines to avail PDP Financing under this route.	RBI	RBI to issue a notification clarifying that raising finances for making PDPs would not be classified as a 'general corporate purpose' (this only arises because of the SLB arrangements).
(v)	***New route for PDP Financing***	Paragraph 2.22.1.1 of the ECB Master Directions permit airlines to raise ECB Financing to meet their working capital requirements: *Airline companies registered under the Companies Act, 1956 and possessing scheduled operator permit license from DGCA for passenger transportation are eligible to raise ECB.* *Such ECBs will be allowed based on the cash flow, foreign exchange earnings and the capability to service the debt.*	This route is subject to the minimum average maturity stipulation of 3 years. The debt needs to be repaid out of foreign exchange earnings of the airline and not from domestic Rupee earnings, thereby making this route unattractive to domestic airlines.	RBI	The RBI to issue a notification enabling airlines to use this route to avail of PDP Financing. Alternatively, RBI may be requested to issue separate guidelines to address PDP Financing availed by airlines as well.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
8.	***Foreign Lenders - ECBs under Automatic Route (for PDP financing)***				
(v)		*The ECBs can be raised with a minimum average maturity period of three years and will be subject to the following terms and conditions:* *a) The overall ECB ceiling for the entire civil aviation sector would be USD 1 billion and the maximum permissible ECB that can be availed by an individual airline company will be USD 300 million.* *b) This limit can be utilized for working capital as well as refinancing of the outstanding working capital Rupee loan(s) availed of from the domestic banking system.* *c) ECB availed for working capital/refinancing of working capital as above will not be allowed to be rolled over.* *The foreign exchange for repayment of ECB should not be accessed from Indian markets and the liability should be extinguished only out of the foreign exchange earnings of the borrowing company.*			
Key Takeaways: *(i) RBI to issue specific directions under Section 11 of Foreign Exchange Management Act, 1999 to provide specific exception for Indian airline companies from these minimum maturity requirements and 'all in cost ceiling' caps.* *(ii) RBI to issue clarification with respect to end use of funds raised for PDP financing.*					
	Foreign Lenders - ECBs under the Approval Route (for PDP financing)				
(v)	***ECB under the approval route***	*ECB proposals beyond the limits (as specified in S. No. (i) above) will come under the approval route.* Schedule II of the Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2002 (Regulations) also prescribe conditions with respect to borrowings in foreign exchange. Minimum Average Maturity Period: *Track 1 and Track 3:* *a) 3 years for ECB up to USD 50 million or its equivalent.* *b) 5 years for ECB beyond USD 50 million or its equivalent.* *Track 2:* *a) 10 years irrespective of the amount.* All-in-cost ceilings: *The all-in-cost ceilings under the approval route are same as referred to in point (iii) above.*	Under the approval route, borrowers are required to make an application to the RBI through an AD Bank. Such cases are considered keeping in view parameters such as the current macroeconomic situation and merits of specific proposals. Borrowers are also required to report any draw-downs as well as payments of any fees/ charges for raising an ECB. The RBI website provides an indicative timeline of 30 days for procuring approvals in respect of ECB financing (though it is pertinent to note that timelines are variable and differ significantly on a case to case basis).	RBI	The individual limits of ECB that can be raised by airlines (for PDP Financing specifically) under the approval route can be increased (from current limit of USD 500 million) by RBI by issuing a specific direction under Section 11 of the FEMA Act. In the event that the RBI is reluctant to bring PDP financing under the automatic route, the RBI may be requested to make a special dispensation under the approval route for PDP financing whereby: (a) the parameters under the approval route are suitably modified for the PDP financing structure; and (b) the timeline for approval of such transactions is compressed subject to the transaction meeting certain criteria pre-defined by the RBI.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
	Foreign Lenders - ECBs under the Approval Route (for PDP financing)				
(v)		Paragraph 6 of Schedule II of the Regulations: *Provided that under these Regulations, the Reserve Bank may, in consultation with the Government of India, prescribe for the approval route, any provision or proviso regarding various parameters listed in paragraphs 1 to 5 above of this Schedule or any other parameter as prescribed by the Reserve Bank and also prescribe the date from which any or all of the existing provisions will cease to exist, in respect of borrowings from overseas, whether in foreign currency or Indian Rupees, such as addition / deletion of borrowers eligible to raise such borrowings, overseas lenders / investors, purposes of such borrowings, change in amount, maturity and all-in-cost, norms regarding security, pre-payment, parking of ECB proceeds, reporting and drawal of loan, refinancing, debt servicing, etc.*	Note that under paragraph (6) of Schedule II of the Regulations, the RBI, in consultation with the Government (read ministry of finance), has the power to vary the stipulations for approval route ECBs with respect to any type of cross border loans.		
Key Takeaways: *RBI to issue specific directions under Section 11 of the FEMA Act increasing the individual limits of ECB that can be raised by airlines (for PDP Financing specifically) under the approval route or the RBI to issue separate regulations under the approval route for PDP financing.*					
	Foreign Lenders - Trade Credits (for PDP financing)				
(I)	***'Import into India'***	Paragraph 5.1 of the ECB Master Directions deal with Trade Credit: *Trade Credits refer to the credits extended by the overseas supplier, bank and financial institution for maturity up to five years for imports into India. Depending on the source of finance, such trade credits include suppliers' credit or buyers' credit. Suppliers' credit relates to the credit for imports into India extended by the overseas supplier, while buyers' credit refers to loans for payment of imports into India arranged by the importer from overseas bank or financial institution. Imports should be as permissible under the extant Foreign Trade Policy of the Director General of Foreign Trade (DGFT).*	The definition of the term 'trade credit' refers to credit for the 'imports into India'. This poses a problem in the context of a typical PDP Financing transaction because of the fact that the rights under the contract are usually assigned to the leasing entity and therefore the airline will not, in most cases, take delivery of the aircraft from the vendor and import it into India	RBI/ Directorate General of Foreign Trade **(DGFT)**	The RBI/ DGFT may be requested to clarify the meaning of 'import into India' in the context of PDP Financing transaction, to ensure that the transaction qualifies as an 'import' despite the arrangement with the leasing entity.
(ii)	***Cap on Automatic Route***	The route and amount of trade credit are prescribed under Paragraph 5.2 of the ECB Master Directions: ***5.2 Routes and Amount of Trade Credit:*** The available routes of raising Trade Credit are mentioned below: ***5.2.1 Automatic Route:*** ADs are permitted to approve trade credit for import of non-capital and capital goods up to USD 20 million or equivalent per import transaction. ***5.2.2 Approval Route:*** The proposals involving trade credit for import of non-capital and capital goods beyond USD 20 million or equivalent per import transaction are considered by the RBI.	By virtue of this restriction, any trade credit exceeding USD 20 million that is availed for the purpose of importing capital goods (such as aircraft), requires prior RBI approval. As with ECBs, the RBI website provides an indicative timeline of 7 days for procuring approvals in respect of availing trade credit (however these timelines too are variable and differ significantly on a case to case basis).	RBI	The RBI may be requested to introduce an enhanced limit under the automatic route specifically for PDP Financing of aircraft.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
	Foreign Lenders - Trade Credits (for PDP financing)				
(iii)	***All in Cost Ceiling***	Paragraph 5.4 of the ECB Master Directions deals with the cost of raising Trade Credit: *The all-in-cost ceiling for raising Trade Credit is 450 basis points over 6 months LIBOR (for the respective currency of credit or applicable benchmark). The all-in-cost include arranger fee, upfront fee, management fee, handling/ processing charges, out of pocket and legal expenses, if any.*	As with ECBs, the ECB Master Directions impose an all-in-cost ceiling on trade credits	RBI	The RBI can issue specific directions under Section 11 of FEMA Act to relax the 'all in cost ceiling' for airlines seeking to access this route for PDP Financing.
(iv)	***Initial Contract Period Requirements***	Paragraph 5.3 of the ECB Master Directions deals with maturity prescription for trade credit: *Maturity prescriptions for trade credit are same under the automatic and approval routes. While for the non-capital goods, the maturity period is up to one year from the date of shipment or the operating cycle whichever is less, for capital goods, the maturity period is up to five years from the date of shipment. For trade credit up to five years, the ab-initio contract period should be 6 (six) months. No roll-over/extension will be permitted beyond the permissible period.*	ECB Master Directions provide that in respect of trade credit up to five years for capital goods, the initial contract period should be 6 months.	RBI	The RBI may be requested to provide a specific exemption under Section 11 of the FEMA Act from the initial contract period for airline companies, if required.

Key Takeaways:

(i) RBI/ DGFT to issue a clarification in respect of the meaning of 'import into India' in the context of PDP Financing transaction.

(ii) The RBI to notify enhanced limits under the automatic route specifically for PDP financing of aircraft.

(iii) The RBI to provide specific exemption under Section 11 of the FEMA Act from the all in cost ceiling caps and initial contract period for airline companies, if required.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
II. AVIATION REGULATIONS					
1.	***Deregistration and Repossession***				
	Background: The Indian regulatory framework provides for a procedure for aircraft owners to deregister and repossess the aircraft upon submission of a plain paper application along with other necessary documents. While there is a procedure laid down by the DGCA for repossession of aircraft, there have been instances where the aircraft owner has had to approach the Courts in India due to impediments. In addition, there have been legal as well as practical impediments for deregistration and repossession of an aircraft due to lack of air operator's consent or claims raised by revenue and airport authorities.				
	Right to detain aircraft by airport operators There have been instances where airport operators have detained aircraft belonging to the lessors for non-payment of dues owed to them by the Lessee even after de-registration.	- Rule 30 (7) of the Aircraft Rules, 1937 provides that: *The registration of an aircraft registered in India, to which the provisions of the Cape Town Convention or Cape Town Protocol apply, shall be cancelled by the Central Government, within five working days, if an application is received from IDERA Holder along with:* *(i) the original or notarised copy of the IDERA recorded with the Director-General;* *(ii) a priority search report from the IR regarding all Registered Interests in the aircraft ranking in priority; and* *(iii) a certificate from the IDERA Holder that all registered interests ranking in priority to that of the IDERA Holder in the priority search report have been discharged or that the holders of such interests have consented to the deregistration.* *Provided that such cancellation of registration of the aircraft shall not affect the right of the Central Government or of any entity thereof, or any inter-governmental organisation in which India is a member, or other private provider of public services in India, to arrest or detain or attach or sell an aircraft object under its laws for payment of amounts owed to the Government of India, any such entity, organisation or provider directly relating to the services provided by such aircraft in respect of that object.* - Regulation 10 of Airport Authority of India (Management of Airports) Regulations, 2003 prescribes that:	The judicial precedents on aircraft repossession suggests that typically Indian courts tend to favour the owner/lessor, citing that their right to repossess supersedes the powers of authorities which seek payments from the operator.[1] However, in addition, we have also seen an instance where the lessor/owner was required to obtain permission from all airport authorities across the country prior to the export of the aircraft. DGCA has also refused to deregister the aircraft on account of objections raised by other revenue authorities.	MOCA and DGCA	As detailed above, the recently notified SOP, inter alia provides for a timeline within which the authorities mentioned in the proviso to Rule 30(7) of the Aircraft Rules must raise their claim and the time period (3 months immediately preceding the date of declared default) for which such a claim must be made. The Government has also proposed a draft Cape Town Convention Bill, 2018 which, when enacted, will ensure full implementation and give overriding effect to CTC.

[1]Cases relied on: *AER Lingus Ltd. vs. Airport Authority of India and Union of India (W.P (C) 618 of 1997 and Notice of Motion No. 586 of 1997 in Suit No. 366 of 1997 decided by the Bombay HC on 9.03.2011), Corporate Aircraft Funding Company LLC vs. Union of India & Ors. (W.P. (C) 792/2012,* decided by the Delhi HC on 14.03.2013),

Awas 39423 Ireland Ltd. and Ors. vs. Directorate General of Civil Aviation and Ors. (W.P.(C) 871 and 747/2015, decided by the Delhi HC on 19.03.2013) and Delhi International Airport Ltd. V International Lease Finance Corpn & Ors. (Civil Appeal No. 2932 of 2015, arising out of SLP (Civil) No.27062/2013, decided by the Supreme Court on 17.03.2015).

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
1.	***Deregistration and Repossession***				
		Unless otherwise provided under the Act or by a general or special order in writing by the Central Government, the use of the movement area of Airport, by an aircraft shall be subject to payment of such landing, parking or housing fees or charges as are levied by the Authority from time to time. In the event of non-payment of the requisite fee or charges, the Competent Authority shall have a right to detain or stop departure of the aircraft till the fees or charges are paid to Authority, which may include the current and accumulated dues. *Provided that in respect of an aircraft which is to be exported under Rule 32A of the Aircraft Rules, 1937, the current and accumulated dues shall include only such dues that accrued in respect of that aircraft and in relation to flights operated by that aircraft during the period comprised of three months immediately preceding the date of declared default upto the date of departure of the aircraft from India.* *Provided further that the Authority shall retain the right to recover the balance dues, if any from the concerned airline.* *Explanation: For the purposes of this regulation, the date of declared default means the date on which the application for deregistration of the aircraft has been submitted to the Directorate General of Civil Aviation under the Aircraft Rules, 1937* - *Para 9.2, Section 2, Series F, Part I of the CARs issued by the DGCA provides that:* *The registration of an aircraft registered in India, to which the provisions of the Cape Town Convention or Cape Town Protocol apply, shall be cancelled by the DGCA, as provided in the Cape Town Protocol, if an application is received from IDERA Holder prior to expiry of the lease along with(i) the original or notarized copy of the IDERA; and (ii) a certificate that all Registered Interests ranking in priority have been discharged or the holders of such interest have consented to the deregistration and export. Provided that the deregistration of an aircraft by the DGCA under para 9.1 and 9.2 shall not affect the right of any entity thereof, or any inter-governmental organization, or other private provider of public services in India to arrest or detain or attach or sell an aircraft object under its laws for payment of amounts owed to the Government of India, any such entity, organization or provider directly relating to the services provided by it in respect of that object.*			The above may to a great extent be able to address the grey areas with respect to CTC, particularly, and without limitation, claims raised by revenue et al.

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
1.	***Deregistration and Repossession***				
		- *Chapter VA of the Airports Authority of India Act, 1934* *Section 28A (Definitions) provides as under:* *In this Chapter, unless the context otherwise requires,–* *(a) "airport premises" means any premises-* *(i) belonging to airport;* *(ii) taken on lease for the purposes of airport;* *(iii) taken on lease for the purposes of airport;* *Explanation.–For the removal of doubts, it is hereby declared that for the purposes of this clause, airport includes private airport;* *(b) "eviction officer" means an officer of the Authority appointed as such by it under section 28B;* *(c) "premises" means any land or building or part of a building, and includes–* *(i) the garden, grounds and outhouses, if any, appertaining to such building or part of a building; and* *(ii) any fittings affixed to such building or part of a building for more beneficial enjoyment thereof;* *(d) "rent", in relation to any airport premises, means the consideration payable periodically for the authorised occupation of the premises, and includes–* *(i) any charge for electricity, water or any other service in connection with the occupation of the premises; and* *(ii) any tax, by whatever name called, payable in respect of the premises;* *(e) "Tribunal" means the Airport Appellate Tribunal established under sub-section (1) of section 28-I;* *(f) "unauthorised occupation", in relation to any airport premises, means the occupation by any person of the airport premises without authority for such occupation and includes the continuance in occupation by any person of the airport premises after the authority (whether by way of grant or any other mode of transfer) under which he was allowed to occupy the premises has expired or has been determined for any reason whatsoever.* Section 28E (Disposal of property left on airport premises by unauthorised occupants) provides as under:			

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
1.	***Deregistration and Repossession***				
		(1) Where any persons have been evicted from any airport premises under section 28D, the eviction officer may, after giving ten days' notice to the persons from whom possession of the airport premises has been taken and after publishing the notice in at least one newspaper having circulation in the locality, remove or cause to be removed or dispose of by public auction any property remaining on such premises. *(2) Where any property is sold under sub-section (1), the sale proceeds thereof shall, after deducting the expenses of the sale and the amount, if any, due to the Central Government or the corporate authority on account of arrears of rent or damages or costs, be paid to such person or persons as may appear to the eviction officer to be entitled to the same:* *Provided that where the eviction officer is unable to decide as to the person or persons to whom the balance of the amount is payable or as to the apportionment of the same, he may refer such dispute to the Tribunal and the decision of the Tribunal thereon shall be final.* Section 28G (Power to require payment of rent or damages in respect of airport premises) provides as under: *(1) Where any person is in arrears of rent payable in respect of airport premises, the eviction officer may, by order, require that person to pay the same within such time and in such instalments as may be specified in the order.* *(2) Where any person is, or has at any time been, in unauthorised occupation of any airport premises, the eviction officer may, having regard to such principles of assessment of damages as may be prescribed, assess the damages on account of the use and occupation of such premises and may, by order, require that person to pay the damages within such time and in such instalments as may be specified in the order.* *(3) While making an order under sub-section (1) or sub-section (2), the eviction officer may direct that the arrears of rent or, as the case may be, damages shall be payable together with simple interest at such rate as may be prescribed.* *(4) No order under sub-section (1) or sub-section (2) shall be made against any person until after the issue of a notice in writing to the person calling upon him to show cause within such period not being less than seven days but not exceeding thirty days as may be specified in the notice as to why such order should not be made, and until his objections, if any, and any evidence he may produce in support of the same have been considered by the eviction officer.*			
	Key Takeaways: *The Government to enact the Cape Town Convention Act to fully implement CTC and provide overriding effect.*				

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
2.	***Indian National Aviation Policy***				
	Background: The National Civil Aviation Policy (NCAP) was issued in June 2016 by the Government of India in an attempt to promote the growth of the aviation sector in India. The policy covers broad areas including regional connectivity, safety and security, traffic rights, ground handling, etc.				
	No mention on aviation financing in the policy *While the policy briefly discusses fiscal support in the context of cargo and ATF infrastructural facilities co-located at the airport, it does not deal with lease financing of aircraft.*		The Ireland National Aviation Policy released in August 2015 has an entire chapter discussing means to incentivise aircraft leasing and financing. A large number of the incentives provided by Ireland relate to fiscal measures in terms of lower tax rates and subsidies on aircraft financing transactions. It is to be noted that the Ireland Policy highlights that the MRO industry was an important factor in supporting the aviation sector. The Indian policy also specifically highlights the need to develop the MRO market in India, basis which certain provisions were made for in the Budget 2016-17 including: - Tools and tool-kits used by the MRO have been exempt from Customs Duty; - Allowing import of unserviceable parts the entire period of maintenance or up to 6 months whichever is lesser, provided it undertakes no commercial flights during the stay period.	MOCA	The tax related recommendations provided in a specific policy released by the authority setting down the road map for aviation leasing and financing industry in India highlighting the fiscal and non-fiscal measures that may support the industry would be highly beneficial. We would like to highlight that a policy (such as NCAP) does not have force of law and is directory.

<table>
<tr><th>S. NO.</th><th>ISSUE</th><th>LEGISLATION CONCERNED</th><th>LEGAL CONSIDERATIONS</th><th>AUTHORITY CONCERNED</th><th>COMMENTS</th></tr>
<tr><td colspan="6">III. OTHER ISSUES</td></tr>
<tr><td>1.</td><td colspan="5">Stamp Duty</td></tr>
<tr><td></td><td colspan="5">Background:
Stamp duty is a documentary tax payable on instruments executed in or brought into India. The amount of stamp duty payable on any instrument varies from State to State, this is because stamp duty is a subject matter of concurrent list (i.e. the Central Government and Governments of each of the States of India have the power to legislate on matters of stamp duty). The ISA, as amended by State legislatures is the principal stamp duty legislation. Do note a few States of India, such as Maharashtra and Gujarat, have stamp duty statutes independent of the ISA, and stamp duty in such States is required to be paid in accordance with the relevant State stamp statute. Under the extant laws for stamp duty in India, if a document is stamped in one state of India and required to be brought into another state of India for the purpose of enforcement, differential stamp duty, if any, will have to be paid on the document.</td></tr>
<tr><td></td><td>Stamp duty exemption in SEZs not available in the state of Gujarat</td><td>High rates of stamp duty are applicable on various instruments/ documents executed in financing transactions. An indicative list of stamp duty applicable on such documents in provided below:
<table>
<tr><th>Document</th><th>Rate of stamp duty (under Gujarat Stamp Act)</th></tr>
<tr><td>Pledge created by the aircraft leasing/ financing entity on the aircraft for availing loan</td><td>Article 6(2):
(i) where the amount of loan or debt does not exceed Rs. 10,00,00,000 (Rupees Ten Crore): 0.25% of the amount of loan
(ii) where it exceeds Rs. 10,00,00,000: 0.50% of the amount of loan (subject to maximum of Rs. 8,00,000)</td></tr>
<tr><td>Aircraft Purchase Agreement</td><td>Article 20(aa):
2% of the amount of the consideration for such conveyance or, as the case may be, the market value of the property which is the subject matter of such conveyance whichever is greater</td></tr>
<tr><td>Lease of aircraft</td><td>Article 30(d):
2% of the amount of average annual rent plus the total amount of fine or premium or money advanced or to be advanced, irrespective of the period for which such lease or agreement to lease is executed.</td></tr>
<tr><td>Issue of shares</td><td>Article 18:
0.1% of the value of the shares</td></tr>
</table>
Section 3(3), ISA & relevant state Stamp Act:
Subject to the provisions of this Act and the exemptions contained in Schedule I, the following instruments shall be chargeable with duty of the amount indicated in that Schedule as the proper duty therefore, respectively, that is to say –
(a) every instrument mentioned in that Schedule which, not having been previously executed by any person, is executed in India on or after the first day of July, 1899;
(b) every bill of exchange payable otherwise than on demand or promissory note drawn or made out of India on or after that day and accepted or paid, or resented for acceptance or payment, or endorsed, transferred or otherwise negotiated, in India; and
(C) every instrument (other than a bill of exchange or promissory note) mentioned in that Schedule, which, not having been previously executed by any person, is executed out of India on or after that day, relates to any property situate, or to any matter or thing done or to be done, in India and is received in India.</td><td>Section 3 of the ISA which provides for instruments chargeable duty has been amended pursuant to Section 57 of the SEZ Act to provide that no duty shall be chargeable in respect of any instrument executed by or on behalf of or in favour of the developer or unit[2] or in connection with the carrying out of the purposes of the SEZ.
As mentioned above the State of Gujarat has a separate stamp duty statute, i.e. the GSA and documents executed in/ brought into the state of Gujarat are subject to the GSA (and not the ISA). In this regard, Section 21 of the Gujarat SEZ Act exempts levy of Stamp duty and registration fees on loan agreements, credit deeds and mortgages executed by the SEZ unit. However, with respect to other instruments, high rates of stamp duty are applicable. Therefore, any lessor located in IFSC will not be exempt from payment of stamp duty on all the instruments executed by it, unless the Gujarat SEZ Act specifically provides for it.</td><td>Revenue Department, MOF and State of Gujarat</td><td>Amendment to the S. 21 of the Gujarat SEZ Act to provide specific exemption from payment of stamp duty on instruments executed in connection with aircraft financing/leasing transactions</td></tr>
</table>

[2] 'Unit' means a unit set up by an entrepreneur in a SEZ and includes an existing Unit, an Offshore Banking Unit and a Unit in an IFSC, whether established before or established after commencement of the SEZ Act;

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
1.	*Stamp Duty*				
		Provided that no duty shall be chargeable in respect of- *(1) any instrument executed by, or on behalf of, or in favour of, the Government in cases where, but for this exemption, the Government would be liable to pay the duty chargeable in respect of such instrument;* *(2) any instrument for the sale, transfer or other disposition, either absolutely or byway of mortgage or otherwise, of any ship or vessel, or any part, interest, share or property of or in any ship or vessel registered under the Merchant Shipping Act 1894, or under Act 19 of 1838, or the Indian Registration of Ships Act, 1841, as amended by subsequent Acts.* ***(3) any instrument executed, by, or, on behalf of, or, in favour of, the Developer, or Unit or in connection with the carrying out of purposes of the Special Economic Zone,*** ***Explanation- For the purposes of this clause, the expressions "Developer", "Special Economic Zone" and "Unit" shall have meanings respectively assigned to them in clause(g), (za) and (zc) of Section 2 of the Special Economic Zones Act, 2005.*** *Section 57 of the SEZ Act provides:* *Amendment of certain enactments—* *With effect from such date as the Central Government may, by notification, appoint, the enactments specified in the Third Schedule shall be amended in the manner specified therein: Provided that different dates may be appointed on which the amendments specified in the Third Schedule shall apply to a particular Special Economic Zone or a class of Special Economic Zones or all Special Economic Zones.* *Section 21 of the Gujarat SEZ Act provides:* ***State taxes and levies –*** *(1) Subject to the provisions of sub-section (1A), all sales and transactions within the processing area of the Zone or in the demarcated area or between the units in the processing area and the demarcated area shall be exempt from all taxes, cess, duties, fees or any other levies under any State law to the extent specified below:*			

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
1.	*Stamp Duty*				
		(a) Stamp duty and registration fees payable on transfer of land meant for approved Units in the processing area of the Zone or in the demarcated area. ***(b) Levy of Stamp duty and registration fees on loan agreements, credit deeds and mortgages executed by the Unit, industry or establishment set up in the processing area of the Zone or in the demarcated area.*** *(c) Tax on sales or purchases of goods other than the goods specified in Schedule III of the Gujarat Value Added Tax, 2003, Luxury Tax, Entertainment Tax and other taxes and cess payable on sales and transactions.* *(1A) The benefits of exemptions under sub-section (1) shall be available to the Unit or a person on the sales and transactions of goods which have been actually and physically involved in the movement of goods.* *(2) Inputs (goods and services) made to the Units in the processing area of the Zone or in the demarcated area from Domestic Tariff Area shall be exempted from tax on sales or purchases of goods other than the goods specified in Schedule III of the Gujarat Value Added Tax, 2003 and other taxes under the State laws.* *(3) The Developer shall also be entitled to the benefits of exemption provided in sub-sections (1) and (2) for the entire Zone.*			
	Differential stamp duty on receipt of documents in another state	*Rates of stamp duty variable in each state in accordance with the concerned stamp duty statute.*	As highlighted above, given that stamp duty is applicable when a document is brought into any other State, any differential stamp duty will be required to be paid as per the applicable stamp duty rates of the particular State. In context of the above-mentioned exemption under Section 3 of the ISA, it is unclear if the exemption from payment of stamp duty will be available if a document is executed in SEZ located in a particular state is received in another state. Therefore, any document executed in the GIFT City but is required to be filed with the DGCA will attract the stamp duty applicable in Delhi for the relevant document.	In case of ISA, the MOF, Government of India; and In other cases, MOF of relevant states.	Clarification under ISA and states having independent stamp statutes stating that the exemption would be applicable even if a document from a SEZ located in one state is received in another state.

<table>
<tr><th>S. NO.</th><th>ISSUE</th><th>LEGISLATION CONCERNED</th><th>LEGAL CONSIDERATIONS</th><th>AUTHORITY CONCERNED</th><th>COMMENTS</th></tr>
<tr><td>1.</td><td colspan="5">Stamp Duty</td></tr>
<tr><td colspan="6">Key Takeaways:
Gujarat State Government to amend the Gujarat SEZ Act to provide specific exemption from payment of stamp duty on instruments executed in connection with aircraft financing/leasing transactions.
Suggested language amendment:
The Gujarat SEZ Act to be amended by the Government of Gujarat and the following to be added in sub-section 1 of section 21 thereof:
"(d) every instrument executed in connection with aircraft financing/ leasing transactions."</td></tr>
<tr><td>2.</td><td colspan="5">Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest</td></tr>
<tr><td colspan="6">Background:
The SARFAESI Act, 2002 is an act which allows banks and other financial institutions to auction properties when borrowers default in the payment of their loans. The SARFAESI Act is applicable only for secured loans wherein banks and financial institutions can enforce the underlying security without any Court intervention, essentially providing them the power to seize.</td></tr>
<tr><td></td><td>Non-applicability of SARFAESI to aircrafts</td><td>Section 31(c) of the SARFAESI Act:
Provisions of this Act not to apply in certain cases—
The provisions of this Act shall not apply to—
(c) creation of any security in any aircraft as defined in clause (1) of section 2 of the Aircraft Act, 1934.</td><td>Section 31(c) of the SARFAESI Act provides that the provisions of this Act are not applicable to the creation of any security in relation to any aircraft. Therefore, the benefits that are otherwise available to the lenders under the SAFAESI Act will not be available to aircraft leasing companies</td><td>MOF</td><td>Amend Section 31(c) of SARFAESI Act to delete the carve-out with respect to aircraft. This will require an amendment to the SARFAESI Act.</td></tr>
<tr><td colspan="6">Key Takeaways:
Central government to amend Section 31(c) of SARFAESI Act to delete the exception with respect to aircraft.</td></tr>
<tr><td>3.</td><td colspan="5">AIRLINES</td></tr>
<tr><td></td><td>Permitting existing Airline operators to set up a branch office in the IFSC</td><td>Currently, all the Airlines have set up their presence in India in the form of a company with its registered office in Delhi or Mumbai (mostly). However, the idea of opening their office in an SEZ has not been explored or thought of</td><td>With the advance of a financial SEZ in GIFT City and the promotion of aircraft financing / leasing from the IFSC, Airlines could consider setting up a Branch office in the IFSC at GIFT City</td><td>DGCA</td><td>DGCA to issue a notification / clarification to this effect permitting Airlines to set up a branch office in the IFSC</td></tr>
<tr><td>4.</td><td>Including DGCA as one of the regulators for an IFSC in respect of aviation financing / leasing</td><td>Currently, the Ministry of Commerce and Industry vide Notification dated 08 April 2015 has included SEBI, RBI and the IRDAI as approved regulators for any financial service activity at the IFSC. However, aviation financing was not included as a specific sector and hence, any Airline were to set up an office in the IFSC, it will only be treated as an SEZ unit as against global practices where such lessors are considered on par with financial service providers</td><td>Given the context of promotion of aircraft financing / leasing from the IFSC and also the option of the Airlines setting up a branch in the IFSC, inclusion of DGCA as one of the regulators will also facilitate the Airlines in being considered as IFSC units.</td><td>Ministry of Commerce and Industry</td><td>Ministry of Commerce and Industry to amend notification</td></tr>
</table>

PART B – TAX

A. INDIRECT TAX

For a detailed analysis of the indirect tax implications on leasing of aircrafts by an Indian leasing company and the issues thereunder, please refer to our detailed analysis in this document.

<table>
<tr><th>S. NO.</th><th>ISSUE</th><th>LEGISLATION CONCERNED</th><th>LEGAL CONSIDERATIONS</th><th>AUTHORITY CONCERNED</th><th>COMMENTS</th></tr>
<tr><td colspan="6">GST on Import of aircraft by leasing company or carrier

Under the current GST regime, an Indian lessor is required to pay Import IGST at 5% on import of aircraft into India. However, Import IGST paid cannot be used to offset GST on lease rentals (refer our detailed analysis in Annexure 1). This represents a prohibitive cost for undertaking lease operations in India. In contrast, carriers importing aircrafts under a lease transaction are exempt from Import IGST. We have provided below measures to mitigate/ neutralise indirect tax implications.</td></tr>
<tr>
<td>1</td>
<td>IGST exemption on import of aircraft is not available when imported by an Indian leasing company.</td>
<td>Entry 540. of Notification 50/2017-Customs exempts import of aircrafts from BCD if certain specified conditions are met by the importer. Import IGST is not exempted, and hence taxable at scheduled rate of 5%.

The relevant extract is provided below:

<table>
<tr><th>Sl. No.</th><th>Chapter, Section, or Heading</th><th>Description of Goods</th><th>Standard Rate (BCD)</th><th>Integrated Goods and Services Tax</th><th>Condition No.</th></tr>
<tr><td>540.</td><td>8802 (except 8802 60 00)</td><td>All goods</td><td>Nil</td><td>–</td><td>79</td></tr>
</table>

"Conditions:

79. (i) imported by an operator or on behalf of the operator, for operating scheduled air transport service or scheduled air cargo service, and such aircraft is used for operating the scheduled air transport service or the scheduled air cargo service, as the case may be; or

(ii)..

Explanation.- For the purposes of this entry,

(a) "operator" means a person, organisation or enterprise engaged in or offering to engage in aircraft operation;

(b) "scheduled air transport service" means an air transport service undertaken between the same two or more places and operated according to a published time table or with flights so regular or frequent that they constitute a recognizably systematic series, each flight being open to use by members of the public; and

(c) "scheduled air cargo service" means air transportation of cargo or mail on a scheduled basis according to a published time table or with flights so regular or frequent that they constitute a recognizably systematic series, not open to use by passengers.</td>
<td>The Ministry of Finance (central government) has exempted BCD applicable on import of aircraft by an 'operator' or on behalf of an 'operator', subject to certain conditions.</td>
<td>Matter to be brought with Ministry of Finance (through CBEC) and GST Council

As a matter of process, recommendation will be made by GST Council which have to be implemented by the Central and State Governments</td>
<td>Under this option, Import IGST should be made "Nil".

<table>
<tr><th>Integrated Goods and Services Tax</th></tr>
<tr><td>Nil</td></tr>
</table>

Condition 79(i) to be amended as follows:

(i) imported by an operator or on behalf of the operator or by an Indian aviation leasing company

Basis these changes, import of aircraft will be made "Nil" when imported by an Indian leasing company.

This would require an amendment of Notification 50/2017-Customs by the Ministry of Finance (central government), on the recommendation of the GST Council</td>
</tr>
</table>

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
2	***Extend IGST exemption available to aircraft imported under an off-shore lease to aircraft imported for on-shore lease.***	Notification 65/2017-Customs dated 08-07-2017 provides an exemption from BCD and Import IGST if aircrafts are imported under a lease arrangement. The relevant extract is provided below: Aircrafts, aircraft engines and other aircraft parts imported into India under a transaction covered by item 1(b) or 5(f) of Schedule II of the Central Goods and Services Tax Act, 2017." The importer, by the execution of bond, in such form and for such sum as may be specified by the Commissioner of Customs, binds himself, - (i) to pay Integrated tax leviable under section 5(1) of the IGST Act, 2017 on supply of service covered by item 1(b) or 5(f) of Schedule II of the Central Goods and Services Tax Act, 2017; (ii) not to sell or part with the goods, without the prior permission of the Commissioner of Customs of the port of importation; (iii) to re-export the goods within 3 months from the expiry of the period for which they were supplied under a transaction covered by item 1(b) or 5(f) of Schedule II of the Central Goods and Services Tax Act, 2017 out of India; (iv) to pay on demand an amount equal to the integrated tax payable on the said goods but for the exemption under this notification in the event of violation of any of the above conditions	The Ministry of Finance has exempted IGST and BCD on the import of an aircraft into India for leasing, subject to certain conditions.	Ministry of Finance of Union and State Governments on recommendation of GST Council	Notification 65/2017 has to be amended as below - The exemption condition related to re-export of the aircraft within 3 months should be relaxed if the import takes place through an Indian aviation leasing company - Condition for not re-selling or parting with the goods to be removed This would require an amendment to Notification 65/2017-Customs by the Ministry of Finance, on the recommendation of the GST Council.
3.	***GST on airplane lease rentals to be specifically exempted***	Notification 8/2017-Integrated tax (Rate) dated 28-06-2017 stipulates that - Entry (iv): leasing of aircrafts by an operator for operating scheduled air transport service or scheduled air cargo service by way of transaction covered by clause (f) paragraph 5 of Schedule II of the Central Goods and Services Act, 2017 is subject to IGST at the rate of 5%, if credit of input tax charged on goods used in supplying the service has not been taken.	Supply of aircraft leasing services is subject to IGST at the rate of 5%,	Ministry of Finance of Union and State Governments on recommendation of GST Council	Amend Notification to specifically exempt services of leasing of aircraft when provided to domestic carriers
4.	*This is not relevant if the IGST exemption (under S.No. 1& 2) is granted* *Currently, Import IGST paid on import of aircraft cannot be offset against output GST paid on lease rentals (conservative position as discussed in our detailed tax analysis) or,* *in case of direct import by carrier, against GST on economy fare.*	Entry 9971 in Notification 8/2017-Integrated tax (Rate) dated 28-06-2017 stipulates that - Entry (iii): Any transfer of right in goods or of undivided share in goods without transfer of title thereof. - Entry (iv): leasing of aircrafts by an operator for operating scheduled air transport service or scheduled air cargo service by way of transaction covered by clause (f) paragraph 5 of Schedule II of the Central Goods and Services Act, 2017 is subject to IGST at the rate of 5%, if credit of input tax charged on goods used in supplying the service has not been taken.	Supply of aircraft leasing services is subject to IGST at the rate of 5%, with the condition that input tax credit is not claimed on import of aircraft. *Note that there is ambiguity on whether sub-entry (ii) or (iv) of entry 9971 would apply in cases of lease of aircraft*	Ministry of Finance of Union and State Governments on recommendation of GST Council	Under this option, the conditions in and (iv) of Notification 8/2017 that stipulates that input tax charged on goods used in supplying services cannot be taken, to be removed. Input credit tax paid on goods (specifically aircraft and aircraft parts) should be permitted to be set-off against GST paid on lease rentals. This would require amendment of Notification 8/2017-Integrated tax (Rate) by the Ministry of Finance, on the recommendation of the GST Council. or

<table>
<tr><th>S. NO.</th><th>ISSUE</th><th>LEGISLATION CONCERNED</th><th>LEGAL CONSIDERATIONS</th><th>AUTHORITY CONCERNED</th><th>COMMENTS</th></tr>
<tr><td>4.</td><td>Import IGST paid on import of aircrafts (other than under a foreign lease transaction) would not be a cost if credit offset is permitted against GST paid on lease rentals (or against economy fare in case of direct import by carrier)</td><td></td><td></td><td></td><td>a clarification be issued that entry 9971(ii) would be the relevant entry for leasing of aircraft by an Indian Leasing Company.</td></tr>
<tr><td>5.</td><td>Dispense requirement of the aircraft being physically required to enter the SEZ area and that the lease rental paid to specifically count toward Net Foreign Exchange (NFE) requirement of an SEZ Unit</td><td>Notification 64/2107 -Customs dated 5 July 2017 exempts all goods imported by an SEZ unit for undertaking authorized operations.

However, to enable this exemption being made available for leasing operations carried out by a Leasing Company in a IFSC, the SEZ legislation is required to be amended

Section 26(1)(a) provides that imports by an SEZ unit are exempt from customs duty, only if:

(i) Such goods are used for 'authorized operations'; and

(ii) Goods are physically brought into the SEZ unit;

Rule 53(k) of the SEZ Rules, 2006 states that

"export of services by services units including services rendered within Special Economic Zone or services rendered in the Domestic Tariff Area and paid for in free foreign exchange or such services rendered in Indian Rupees which are otherwise considered as having been paid for in free foreign exchange by the Reserve Bank of India"</td><td>Exemption from customs duty is only available if the goods are physically brought into the SEZ unit</td><td>Central Government</td><td>Amendment in section 26(1)(a) of the SEZ Act and an amendment of the SEZ Rules, 2006 by the Central Government to provide for the following:

• Dispense requirement of aircraft being physically required to enter the SEZ area (and stay therein);and

• Lease rental paid (whether or not in forex) to count toward Net Foreign Exchange (NFE)</td></tr>
<tr><td colspan="6">Suggested amendment language</td></tr>
<tr><td>1.</td><td>Exemption of Import IGST on import of aircraft by Indian leasing company</td><td>Notification to be issued by the Central Government exempting customs duty (i.e. basic customs duty and Import IGST) where aircraft is imported into India by an Indian Leasing Company.</td><td colspan="3">Language for notification to be issued under the Customs Act, 1962 and Customs Tariff Act, 1975 amending Notification no. 50/2017 dated 30 June 2017.

In exercise of the powers conferred by sub-section (1) of section 25 of the Customs Act, 1962 (52 of 1962) and sub-section (12) of section 3 of Customs Tariff Act, 1975 (51 of 1975), the Central Government, being satisfied that it is necessary in the public interest so to do, hereby makes the following amendment in the notification of the Government of India, in the Ministry of Finance (Department of Revenue), No. 50/2017- Customs, dated the 30th June, 2017, published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (i), vide number G.S.R. 785(E), dated the 30th June, 2017, namely:-In the said notification,(a) in the Table, -

<table><tr><td>(I) after serial number 540 and the entries relating thereto, the following serial shall number and entries shall be inserted, namely: -[ ]</td><td>Chapter 99</td><td>Services of leasing of aircraft by a leasing company to operators</td><td>Nil</td><td>Nil</td></tr></table></td></tr>
</table>

<table>
<tr><th>S. NO.</th><th>ISSUE</th><th>LEGISLATION CONCERNED</th><th>LEGAL CONSIDERATIONS</th><th>AUTHORITY CONCERNED</th><th>COMMENTS</th></tr>
<tr><td colspan="6">Suggested amendment language</td></tr>
<tr><td>1.</td><td></td><td></td><td colspan="3">(b) in the Annexure, after condition No. 79, the following condition shall be inserted, namely: -

79A. If, -
(i) imported by a leasing company or on behalf of the leasing company, for lease to operators operating scheduled air transport service or scheduled air cargo service, and such aircraft is used for operating the scheduled air transport service or the scheduled air cargo service, as the case may be;
Explanation.- For the purposes of this entry,
(a) "operator" means a person, organisation or enterprise engaged in or offering to engage in aircraft operation;
(b) "scheduled air transport service" means an air transport service undertaken between the same two or more places and operated according to a published time table or with flights
(c) "leasing company" means a company engaged in leasing of aircrafts to operators, where lease rentals account for more than 50% of the turnover of the unit [TL Note: highlighted part is optional and this may be inserted if revenue wishes to define leasing company narrowly]</td></tr>
<tr><td>2.</td><td>Extend IGST exemption available to aircraft imported under an off-shore lease to aircraft imported for on-shore lease</td><td>IGST exemption in serial no 547A of Notification 50/2017 dated 30 June 2017 to be amended to remove re-export and non-transfer condition where aircraft imported on lease from an Indian leasing company</td><td colspan="3">Language for notification to be issued under the Customs Act, 1962 and Customs Tariff Act, 1975 amending Notification no. 50/2017 dated 30 June 2017.

In exercise of the powers conferred by sub-section (1) of section 25 of the Customs Act, 1962 (52 of 1962) and sub-section (12) of section 3 of Customs Tariff Act, 1975 (51 of 1975), the Central Government, being satisfied that it is necessary in the public interest so to do, hereby makes the following amendment in the notification of the Government of India, in the Ministry of Finance (Department of Revenue), No. 50/2017- Customs, dated the 30th June, 2017, published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (i), vide number G.S.R. 785(E), dated the 30th June, 2017, namely:-

In the said notification,

(a)in the Annexure, in Condition No. 102, after clause (iv) the following provisio shall be inserted, namely:

"Provided that condition (iii) and (iv) shall not apply where the lessor is a leasing company

"leasing company" means a company engaged in leasing of aircrafts to operators, where lease rentals account for more than 50% of the turnover of the unit" [TL Note: highlighted part is optional and this may be inserted if revenue wishes to define leasing company narrowly]</td></tr>
<tr><td>3.</td><td>Exempt GST on airplane lease rentals</td><td>"Nil" rate of GST on leasing of aircraft by domestic leasing company to Indian operators</td><td colspan="3">Sample language for IGST Notification provided below, where Notification no. 09/2017 dated 28 June 2017 (which provides exemption to various services) would have to be amended:

Notification - Integrated Tax (Rate):

In exercise of the powers conferred by sub-section (1) of section 6 of the Integrated Goods and Services Tax Act, 2017 (13 of 2017), the Central Government, on being satisfied that it is necessary in the public interest so to do, on the recommendations of the Council, hereby makes the following amendments in the notification of the Government of India, in the Ministry of Finance (Department of Revenue), No.9/2017- Integrated Tax (Rate), dated the 28th June, 2017, published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (i), vide number G.S.R. 684(E), dated the 28th June, 2017, namely:-

In the said notification,-

I) in the Table,-</td></tr>
</table>

<table>
<tr><th>S. NO.</th><th>ISSUE</th><th>LEGISLATION CONCERNED</th><th>LEGAL CONSIDERATIONS</th><th>AUTHORITY CONCERNED</th><th>COMMENTS</th></tr>
<tr><td colspan="6">Suggested amendment language</td></tr>
<tr><td>3.</td><td></td><td></td><td colspan="3">
(a) after serial number [ ] and the entries relating thereto, the following shall be inserted namely:-
<table>
<tr><td>[ ]</td><td>Chapter 99</td><td>Services of leasing of aircraft by a leasing company to operators</td><td>Nil</td><td>Nil</td></tr>
</table>
(ii) in paragraph 2, after clause [ ], the following clauses shall be inserted, namely:-
[ ] “leasing company” means a company engaged in leasing of aircrafts to operators, where lease rentals account for more than 50% of the turnover of the unit [TL Note: highlighted part is optional and this may be inserted if revenue wishes to define leasing company narrowly]
[] “operator” means a person, organisation or enterprise engaged in or offering to engage in aircraft operation
</td></tr>
<tr><td>4.</td><td> Permit input GST credit on goods (aircraft and parts thereof) for lessor This is not relevant if the IGST exemption (under S.No 1& 2) is granted </td><td></td><td colspan="3">
Notification to be issued under the IGST, CGST, UTCGS, SGST laws.
Sample language for IGST Notification provided below, where Notification no. 08/2017 dated 28 June 2017 (which provides IGST rate for specific services) would have to be amended:
Notification - Integrated Tax (Rate)
In exercise of the powers conferred by sub-section (1) of section 5, subsection (1) of section 6 and clause (iii) and clause (iv) of section 20 of the Integrated Goods and Services Tax Act, 2017 (13 of 2017) read with sub-section (5) of section 15 and sub-section (1) of section 16 of the Central Goods and Services Tax Act, 2017 (12 of 2017), the Central Government, on the recommendations of the Council, and on being satisfied that it is necessary in the public interest so to do, hereby makes the following amendments in the notification of the Government of India, in the Ministry of Finance (Department of Revenue), No. 8/2017- Integrated Tax (Rate), dated the 28th June, 2017, published in the Gazette of India, Extraordinary, Part II, Section 3, Sub-section (i), vide number G.S.R. 683(E), dated the 28th June, 2017, namely:-
In the said notification, in the Table,-
(I) against serial number 15,- for item (iv) in column (3), the entries relating thereto in columns (3), (4) and (5) shall be substituted, namely:-
<table>
<tr><td>(3)</td><td>(4)</td><td>(5)</td></tr>
<tr><td>Leasing of aircrafts by an operator for operating scheduled air transport service or scheduled air cargo service by way of transaction covered by clause (f) paragraph 5 of Schedule II of the Central Goods and Services Act, 2017. Explanation.- (a) “operator” means a person, organisation or enterprise engaged in or offering to engage in aircraft operations; (b) “scheduled air transport service” means an air transport service undertaken between the same two or more places operated according to a published time table or with flights so regular or frequent that they constitute a recognizable systematic series, each flight being open to use by members of the public; (c) “scheduled air cargo service” means air transportation of cargo or mail on a scheduled basis according to a published time table or with flights so regular or frequent that they constitute a recognizably systematic series, not open to use by passengers</td><td>5%</td><td>-</td></tr>
</table>
</td></tr>
</table>

S. NO.	ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
Suggested amendment language					
5.	Dispense requirement of the aircraft being physically required to enter the SEZ area and that the lease rental paid to specifically count toward Net Foreign Exchange (NFE) requirement of an SEZ Unit	Amendment to the SEZ Act and SEZ Rules by the Central Government	*SEZ legislation to be suitably amended to state that leasing of aircraft to be considered as 'authorised operations' when provided by an Indian Leasing Company to in an IFSC and that such leasing operations to count towards NFE fulfilment* *Further, legislation to be amended to provide that aircraft is not required to be physically bought into an SEZ*		

B. DIRECT TAX

ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
Interest ***There is a special regime for taxing interest income of certain offshore investors from lending operations - this is taxed at a concessional rate of 5%, provided certain conditions are met. This should be extended to IFSC Units***	Section 10 of the Income-Tax Act, 1961 provides exemptions provides exemptions to various kinds of income which the Central Government deems necessary to grant for any reason. *Section 194LC(1) of the Income-Tax Act, 1961 states:* *"Where any income by way of interest referred to in sub-section (2) is payable to a non-resident, not being a company or to a foreign company by a specified company or a business trust, the person responsible for making the payment, shall at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct the income-tax thereon at the rate of five per cent.* *. . ."* *Section 194LD(1) of the Income-Tax Act, 1961 states:* *"Any person who is responsible for paying to a person being a Foreign Institutional Investor or a Qualified Foreign Investor, any income by way of interest referred to in sub-section (2), shall, at the time of credit of such income to the account of the payee or at the time of payment of such income in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of five per cent.* *. . ."*	The interest income of offshore investors from lending operations are taxed at 5% under the Income-Tax Act, 1961 in the case of a: (i) foreign currency loan (ii)rupee denominated bond issued to a foreign portfolio investor and at the applicable corporate tax rate / MAT rate for lenders located in the IFSC	Central Board of Direct Taxes/ Central Government	Any interest paid by a Leasing company in the IFSC to a lender should be exempted from withholding tax requirements.
MAT ***IFSC units are subject to MAT rate of 9%. This leads to cash flow problems.*** ***MAT should be exempted for aircraft lessors operating out of an IFSC***	Section 115JB(7) of the Income-Tax Act, 1961 states that: "Notwithstanding anything contained in sub-section (1), where the assessee referred to therein, is a unit located in an International Financial Services Centre and derives its income solely in convertible foreign exchange, the provisions of sub-section (1) shall have the effect as if for the words "eighteen and one-half per cent" wherever occurring in that sub-section, the words "nine per cent" had been substituted."	The book profits (as discussed in note 2) of an IFSC unit are subject MAT at the rate of 9%.	Central Board of Direct Taxes/ Central Government	MAT should be exempted/reduced to Nil for leasing company located in an IFSC. This change would be in the form of an amendment in the IT Act by specifically adding a proviso to this effect after Section 115JB(7).

ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
Tax holiday ***Currently an IFSC unit is entitled to 100% deduction of income for first 5 years of obtaining the permission and 50% deduction for 5 years thereafter.*** ***Alternately, given that leasing units are unlikely to have profits in the initial few years; to make the current tax holiday more attractive; it should be available for any 10 consecutive years in the first 15 years***	Section 80LA of the Income Tax Act, 1961 states that: *"(1) Where the gross total income of an assessee,—* *(ii) being a Unit of an International Financial Services Centre, includes any income referred to in sub-section (2), there shall be allowed, in accordance with and subject to the provisions of this section, a deduction from such income, of an amount equal to—* *(a) one hundred per cent of such income for five consecutive assessment years beginning with the assessment year relevant to the previous year in which the permission, under clause (a) of sub-section (1) of section 23 of the Banking Regulation Act, 1949 (10 of 1949) or permission or registration under the Securities and Exchange Board of India Act, 1992 (15 of 1992) or any other relevant law was obtained, and thereafter;* *(b) fifty per cent of such income for five consecutive assessment years.* *(2) The income referred to in sub-section (1) shall be the income—* *(c) from any Unit of the International Financial Services Centre from its business for which it has been approved for setting up in such a Centre in a Special Economic Zone."*	An IFSC unit has been given a tax holiday under the Income Tax Act, 1961. It's income is subject to: (a) 100% income deduction for the first 5 years of obtaining a permission from the Banking Regulation Act, 1949 or Securities and Exchange Board of India Act, 1992. (b) 50% income deduction for the 5 years thereafter.	Central Board of Direct Taxes/ Central Government	Section 80LA should be amended to increase tax holiday for units in IFSC (or specifically aircraft leasing units). Current tax holiday of 10 years (100% for 5 years and 50% for 5 years) to be available in any ten consecutive years period in the first 15 years.
Capitalgainstaxon transfer/resaleofaircraft ***Currentlysale/resaleof aircraftsbyaleasing companyinanIFSCunit attractscapitalgainstaxon thecapitalgainsmade. Capitalgainstaxshouldbe exempton sale/resaleof aircraftsbyaleasing companyintheIFSC.***	Section 45 of the Income Tax Act, 1961 states that: "(1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections 54, 54B, 54D, 54E, 54EA, 54EB, 54F, 54G and 54H, be chargeable to income-tax under the head "Capital gains", and shall be deemed to be the income of the previous year in which the transfer took place."	Sale/resale of aircrafts if results into gains attracts capital gains tax under Section 45 of the Income Tax Act, since aircrafts qualify as capital asset under Section 2(14) of the Income Tax Act, 1961.	Central Board of Direct Taxes/ Central Government	Sale/resale of aircrafts by leasing company located in an IFSC should be exempted from capital gains tax either by -classifying as 'not a transfer' under Section 47; or as a 'income not included in total income' under Section 10 of the Income Tax Act, 1961.
Capital gains tax on bonds and derivatives ***Currently, there is a capital gains exemption for transfer of bonds or derivatives in a unit in IFSC by a non-resident investor.*** ***This exemption should be extended to resident investors***	Section 47 (viiiab) of the Income Tax Act, 1961 reads as follows: *Nothing contained in section 45 shall apply to the following transfers,-* *...* *(viiab) any transfer of a capital asset being -* *(a) bond or Global Depository Receipt referred to in sub-section (1) of section 115AC; or* *(b) rupee denominated bond of an Indian company; or* *(c) derivative,* *made by a non-resident on a recognised stock exchange located in any International Financial Services Centre and where the consideration for such transaction is paid or payable in foreign currency.*	There is **no capital gains exemption** for transfer of bonds or derivatives in a unit in IFSC by **a resident investor**	Central Board of Direct Taxes/ Central Government	Extend capital gains exemption available to non-residents in respect of transfer of bonds, derivatives in a stock exchange in an IFSC to a resident investor in a leasing company. Note that a company registered under the Indian company laws is deemed to be a resident under the Income tax laws. Therefore, the exemption in its current form will not be applicable for an IFSC unit on transfer of specific capital assets (bonds, derivatives etc.) by a resident.
Additional Dividend Tax	Section 115BBDA of the Income-Tax Act, 1961, reads as follows: *(1) Notwithstanding anything contained in this Act, where the total income of a specified assessee, resident in India, includes any income in aggregate exceeding ten lakh rupees, by way of dividends declared, distributed or paid by a domestic company or companies, the income-tax payable shall be the aggregate of-* *(a) the amount of income-tax calculated on the income by way of such dividends in aggregate exceeding ten lakh rupees, at the rate of ten per cent; and* *(b) ....<not relevant>* *Explanation-For the purposes of this section,-* *(a) "dividend" shall have the meaning assigned to it in clause (22) of section 2 but shall not include sub-clause (e) thereof;*	Even though DDT is exempt in case of unit of IFSC, HNIs (and other non-company/ non-specified investment trust shareholders) are liable to 10% income tax on dividend income above INR 1 million	Central Board of Direct Taxes/ Central Government	Specific proviso to be inserted after sub-section (1) into Section 115BBDA to exclude dividend income earned from an leasing company located in an IFSC.

ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
Additional Dividend Tax	*(b) "specified assessee" means a person other than,-* *(i) a domestic company; or* *(ii) a fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of section 10; or* *(iii) a trust or institution registered under section 12A or section 12AA.*			
Increased deduction for airline companies on lease rentals paid to leasing companies in the IFSC		Deduction is currently available of the lease rentals paid by airlines to leasing companies located both within and outside India	Central Board of Direct Taxes/ Central Government	New section to be inserted in the income tax laws which incentivizes airlines to take aircrafts on lease from leasing companies located in an IFSC by offering increased deduction to the extent of 125% of the lease rentals, if paid to leasing companies located in an IFSC
Remove withholding tax on lease rentals paid by airline companies to aircraft leasing companies in the IFSC	Section 194-I of the Income-Tax Act, 1961, reads as follows: *Any person, not being an individual or a Hindu undivided family, who is responsible for paying to a resident any income by way of rent, shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of—* *(a)two per cent for the use of any machinery or plant or equipment; and* *(b)ten per cent for the use of any land or building (including factory building) or land appurtenant to a building (including factory building) or furniture or fittings:*	Lease rentals paid by airline companies are subject to withholding tax at 2% (10% of interest portion if structured as finance lease transaction)	Central Board of Direct Taxes/ Central Government	Specific exemption to be inserted providing for Nil withholding tax to be paid by airline companies on lease rentals paid to airline leasing companies located in an IFSC whether structured as lease rentals or finance charges
Reduction of useful life of aircrafts to compute depreciation – effect of reduction of MAT impact	Schedule II under section 123 of the Companies Act, 2013 provides as follows: *SCHEDULE II* *(See section 123)* *USEFUL LIVES TO COMPUTE DEPRECIATION* *PART 'A'* *.....* *PART 'C'* *VIII. Aircrafts or Helicopters [NESD] 20 Years*	MAT is calculated based on book profits as per the Companies Act, 2013, which provides for depreciation under the straight-line depreciation method. Further, depreciation under is based on the stipulated useful life of the aircraft.	Ministry of Corporate Affairs / Central Government	Reduction of useful life of aircraft under the Companies Act, 2013, in the hands of a leasing company incorporated in the IFSC, to 12 years. This increases the amount of straight line depreciation available each year, leading to lower book profits, and consequently reducing or eliminating MAT implications. Notification to be issued.

ISSUE	LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
Relax GAAR provisions	Chapter X-A of the Income-tax Act, 1961 deals with General Anti Avoidance Rules wherein tax benefits / incentives may be denied to tax payers if a transaction (or a step in it) is considered to have been entered into with a main purpose of avoiding / evading income-tax.	With the objective of promoting aviation financing / leasing in IFSC, certain additional tax benefits are being proposed to be granted by the Government of India to the Indian Airline Companies and the Lessors setting up a presence in IFSC. Currently, the Act also provides certain exemptions to an entity set up in an IFSC. However, if GAAR is invoked by the Income-tax authorities, there is a potential risk of denial of these Income-tax benefits / exemptions; especially where existing lease arrangements are novated/restructured to units in an IFSC. Indian Airline Companies and the Lessors setting up a presence in IFSC need certainty that GAAR provisions will not be invoked against them in order for them to consider moving to IFSC.	Central Board of Direct Taxes/ Central Government	Clarification / notification should be issued to exclude IFSC transactions from the purview of GAAR provisions. Transfer/ novation of aircraft financing / leasing contracts to units in an IFSC should not be under the purview of GAAR, for both the lessee and lessor.

Suggested amendment language

1.	**Exemption on interest received from a leasing company located in an International Financial Services Centre**	An amendment may be proposed in the Finance Bill 2019 exempting interest received from a leasing company located in an International Financial Services Centre.	Sample language for the proposed amendment is provided below *After clause (4), the following clause shall be inserted, namely-* *"4A interest received by a resident from a leasing company which is a unit located in an International Financial Services Centre"* *Explanation-* *For the purposes of this clause,-* *(a) "International Financial Services Centre" shall have the same meaning as assigned to it in clause (q) of section 241 of the Special Economic Zones Act, 2005 (28 of 2005);* *(b) "Unit" shall have the same meaning as assigned to it in clause (zc) of section 2 of the Special Economic Zones Act, 2005.* *(c) "leasing company" means a company engaged in leasing of aircrafts to operators, where lease rentals account for more than 50% of the turnover of the unit [Their definitions can be inserted in section 2 or in each of the relevant sections]*

ISSUE		LEGISLATION CONCERNED	LEGAL CONSIDERATIONS / AUTHORITY CONCERNED / COMMENTS
Suggested amendment language			
2.	**Exemption of Minimum Alternate Tax (MAT) on IFSC units**	Removal of MAT at the rate of 9% by way of an amendment to sub-section 7 of section 115JB of the Income-tax Act, 1961. This amendment would have to be in proposed in the Finance Bill 2019. Language for an amendment:	*"for sub-section (7) of section 115JB of the Income-tax Act, the following sub-section shall be substituted with effect from April 1, 2019, namely:-* *(7) Notwithstanding anything contained in sub-section (1), where the assessee referred to therein, is a leasing company which is a unit located in an International Financial Services Centre and derives its income solely in convertible foreign exchange, the provisions of sub-section (1) shall not apply.* *Explanation – For the purposes of this sub-section-* *(a) "International Financial Services Centre" shall have the same meaning as assigned to it in clause (q) of section 2 of the Special Economic Zones Act, 2005 (28 of 2005);* *(b) "Unit" shall have the same meaning as assigned to it in clause (zc) of section 2 of the Special Economic Zones Act, 2005;* *(c) "convertible foreign exchange" means a foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purposes of the Foreign Exchange Management Act, 1999 (42 of 1999) and the rules made thereunder."* *"leasing company" shall mean a unit located in an International Financial Service Centre, where lease rentals account for more than 50% of the turnover of the unit.*
3.	**Tax holiday for longer period**	**Option 1:** Tax holiday extended to 100% for 10 years (instead of current initial five years) followed by 50% for five years (as already provided). **Option 2:** Tax holiday extended to 100% for any five consecutive years (instead of current initial five years) followed by 50 for five years (as already provided) to be taken in 10 consecutive period in the first 15 years	An amendment should be proposed to section 80LA of the Income Tax Act, 1961 in Finance Bill 2019. Language of the proposed amendment: *"In sub-section 1 of section 80LA of the Income-tax Act, in sub-clause(ii), after (b), the following proviso shall be added* *Provided that where the Unit of an International Financial Services Centre is an airline leasing company, the provisions of sub-clause shall have the effect as if for the words "five consecutive assessment years" the words "ten consecutive assessment years" shall be substituted from the 1st day of April 2019."* For this, an amendment should be proposed to section 80LA of the Income Tax Act, 1961 in Finance Bill 2019. Language of the proposed amendment: *"In sub-section 1 of section 80LA of the Income-tax Act, in sub-clause(ii), after (b), the following proviso shall be added* *Provided that where the Unit of an International Financial Services Centre is an airline leasing company, the provisions of sub-clause shall have the effect as if for the words "five consecutive assessment years" the words "five consecutive assessment years out of any ten consecutive assessment years" shall be substituted from the 1st day of April 2019."*
4.	Exempt capital gains on bonds or derivatives in a unit in International Financial Services Centre	Capital gain tax should be proposed to be exempt on gains arising from transfer of bonds or derivatives issued by a unit in an International Financial Services Centre by a resident. This amendment would have to be in proposed in the Finance Bill 2019.	Sample language of the proposed amendment: *"In clause (viiab) of section 47 of the Income-tax Act, after sub-clause (c), the following sub-clause (d) shall be inserted:* *(e) any long-term bonds including long-term infrastructure bonds and derivatives subscribed to by a resident investor."*

ISSUE		LEGISLATION CONCERNED	LEGAL CONSIDERATIONS	AUTHORITY CONCERNED	COMMENTS
Suggested amendment language					
5.	**Remove withholding tax on lease rentals paid by airline companies to aircraft leasing companies in the IFSC**	Lease rentals paid by airline companies are subject to withholding tax at 2% under section 194-I. This amendment would have to be in proposed in the Finance Bill 2019.	Sample language of the proposed amendment: *"In section 194-I of the Income-tax Act, after sub-clause (a), the following sub-clause (aa) shall be inserted:* ***(aa)zero per cent for the use of any aircraft or aircraft engines or parts thereof, when leased by an Indian Leasing Company located in IFSC"*** *194A, to be amended by inserting the following:* *Zero per cent in respect of interest payable to an Indian leasing company in IFSC for financing the purchase of any aircraft or aircraft engine*		
6.	**Reduction of useful life of aircrafts to compute depreciation – effect of reduction of MAT impact**	Amendment to Schedule II under section 123 of the Companies Act, 2013	Notification to be issued under the Companies Act amending SCHEDULE II, PART 'C' entry VIII to provide that "Aircrafts or Helicopters [NESD]" have a useful life of 12 Years		
7.	Clarification that GAAR will not be applicable for novation/ transfer of existing leases to an unit in IFSC	Amendment to Section 95 or 96 of chapter X-A of the Income Tax Act, 1961	An amendment can be made to section 95 or section 96 of the Income Tax Act, 1961 in Finance Bill 2019. Language of the proposed amendment: *Option 1: Amendment to section 95* *"In section 95 of the Income-tax Act, after sub-clause (2), the following sub-clause (3) shall be inserted* *(3) Provided that the provisions of chapter X-A will not be applicable to any transfer or novation of aircraft financing and or leasing contracts to a unit or units in an IFSC"* *Option 2: Amendment to section 96* *"In section 96 of the Income-tax Act, after sub-clause (2), the following sub-clause (3) shall be inserted* *(3) Provided that any transfer or novation of aircraft financing and or leasing contracts by a lessee to a unit or units in an IFSC will not qualify as an impressible avoidance arrangement."*		

APPENDIX-1

1. Indirect Tax implications: Pre-Goods and Service Tax (GST) regime

This analysis is important as aircraft lease were executed outside India due to arbitrage of VAT on lease rental on offshore leases. Under the GST regime, this arbitrage has continued.

1.1. Import of aircraft

Customs duty was exempt on aircrafts imported into India by operators intending to use such aircrafts for scheduled passenger and/or cargo operations.

1.2. *Leasing of aircraft: Offshore and on-shore*

Under the pre-GST tax regime, sale or lease of aircrafts in India were subject to VAT/CST. To avoid this levy of VAT/CST, carriers entered into aircraft leasing arrangements outside India, as lease transactions executed outside India were beyond the jurisdiction for levy of VAT/CST.

1.3. *Sale of aircraft in India*

Sale of aircraft in India was subject to VAT/CST.

1.4. *Provision of air transport services*

Air transport services provided by carriers in India were subject to service tax. VAT/CST paid on lease of aircrafts could not be offset against the output service tax liability of the carriers. Therefore, this VAT/CST was a cost for carriers.

Given this, offshore lease transactions were preferred by carriers to avoid levy of VAT/CST; this included sending the aircraft outside India for end of lease servicing and executing fresh lease while the aircraft was outside India. This provided a clear advantage to foreign lessors.

2. Tax implications: GST regime

2.1. Overview of relevant indirect taxes

2.1.1. GST

With effect from 1 July 2017, all major indirect taxes (including central excise, service tax, VAT) in India have been subsumed under the GST regime[3]. GST is a dual levy where a Central GST (CGST) and a State GST (SGST) is levied on intra-state supply of goods and or services. CGST and SGST are levied at the same rates and on the same taxable value of supply. The *cumulative* GST rate (CGST + SGST) ranges between 5% (2.5% CGST + 2.5 SGST) to 28% (14% CGST + 14% SGST).

Integrated GST (IGST) is charged on inter-state supplies, which include import of goods into India. The rate of IGST is the consolidated CGST and SGST rate.

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[3]Alcohol for human consumption and specified petroleum products have been excluded from the ambit of GST.

Taxable event

The taxable event for levy of GST is 'supply' of goods and/or services. 'Supply' includes within its ambit, all forms of supply such as sale, transfer, barter, exchange, license, rental, lease etc. undertaken for a consideration in the course or furtherance of business. Some specific activities (such as inter-branch transfers) are also 'deemed to be supplies'.

GST credit mechanism

A person registered under GST laws can avail credit of tax paid on the inward supply of goods or services or both, which is used or intended to be used in the course or furtherance of business[4]. This input tax credit can be utilised to pay GST on output taxable supplies, subject to certain pre-requisites. However, for specific taxable supplies, the GST laws prescribe restrictions on availing input GST credit on either or both goods and services.

2.1.2. Customs duty

The Customs Act, 1962 (Customs Act) regulates the import and export of goods into and out of India. Customs duty is payable on all goods imported into India or exported out of India at such rates as may be specified under Customs Tariff Act, 1975 (Customs Tariff Act). Custom duty is comprised of the following components:

- Basic Customs Duty (BCD) levied under the Customs Act, 1962. BCD is a levy by the Central government and is payable at the rates prescribed in the Customs Tariff Act, 1975 (Customs Tariff Act). The Customs Tariff is aligned to the internationally prevalent Harmonized System of Nomenclature.
- IGST (Import IGST) levied as a component of customs duty under section 3(7) of the Customs Tariff Act.
- Education cess levied under section 3(9) of the Customs Tariff Act.
- Compensation cess (if applicable)

Customs duty is payable by the importer on record who is required to obtain an Import Export Code (IEC).

Rates

BCD rates depend on the classification of imported goods under the Customs Tariff Act, which is aligned with the International Harmonized System of Nomenclature (HSN). IGST is levied at such rate levied provided under the Integrated GST Act, 2017 (IGST Act) on a like article on its supply.

Credit mechanism

BCD paid on import of goods is not creditable and is a cost. However, Import IGST paid as a component of customs duty is creditable against output GST liability.

[4]Section 16 of the CGST Act, 2017

2.2. Indirect tax implications

We have examined the indirect tax implications on the various legs of an aircraft leasing transaction

2.2.1. Import of aircraft

A. Import of aircraft under a lease arrangement

Customs duty i.e. BCD and Import IGST is exempt where aircrafts or parts of aircrafts, are imported into India under a lease transaction. Notification 65/2017-Customs exempts customs duty on import of aircrafts, aircraft engines and other aircraft parts under a lease transaction:

> "*Aircrafts, aircraft engines and other aircraft parts imported into India under a transaction covered by item 1(b) or 5(f) of Schedule II of the Central Goods and Services Tax Act, 2017.*"
>
> *The importer, by the execution of bond, in such form and for such sum as may be specified by the Commissioner of Customs, binds himself, -*
>
> *(i) to pay Integrated tax leviable under section 5(1) of the IGST Act, 2017 on supply of service covered by item 1(b) or 5(f) of Schedule II of the Central Goods and Services Tax Act, 2017;*
>
> *(ii) not to sell or part with the goods, without the prior permission of the Commissioner of Customs of the port of importation;*
>
> *(iii) to re-export the goods within 3 months from the expiry of the period for which they were supplied under a transaction covered by item 1(b) or 5(f) of Schedule II of the Central Goods and Services Tax Act, 2017 out of India;*
>
> *(iv) to pay on demand an amount equal to the integrated tax payable on the said goods but for the exemption under this notification in the event of violation of any of the above conditions.*

Further, to avail this exemption, aircraft and other parts are required to be imported into in India under a "transaction covered by item 1(b) or 5(f) of Schedule II" of the CGST Act, which includes:

(i) Item 1(b) of Schedule II - transfer of right in goods or of undivided share in goods without transfer of title

(ii) Item 5(f) of Schedule II - transfer of the right to use any goods for any purpose for cash, deferred payment or other valuable consideration (*in other words, a lease transaction*)

Additionally, to avail this exemption an importer is also required to fulfil the following conditions:

a) to pay IGST levied under section 5(1) of the IGST Act, 2017 on lease rentals (i.e. services covered by item 1(b) or 5(f) of Schedule II of the CGST Act, 2017)

b) not to sell or part with the imported goods, without the prior permission of the Commissioner of Customs of the port of importation;

c) to re-export the goods within 3 months from the expiry of the lease period

d) to pay on demand an amount equal to the IGST payable on the said where the importer violates these conditions

Thus, this exemption is only available where the aircraft is imported under a lease transaction. Further, from the way the exemption conditions are worded, it implies that the lease rentals should be payable to a lessor located outside India. In other words, the lease itself should directly occasion the import of the aircraft in India. This is clear from the fact that one of the exemption condition stipulates that the aircraft must be re-exported after the expiry of the lease period.

This exemption would also not be available on a 'bill-to ship-to' model; though the carrier in India will be importer on record, the conditions in the exemption would not be met as (a) the lease rentals would not be paid to a lessor located outside India (b) re-export of the aircraft is not contemplated within the terms of the import.

B. *Import of aircraft by an Indian leasing company*

Import of aircraft would be subject to the following:

- Import IGST at the rate of 5% on the value of the aircraft
- BCD would be exempt, where the aircraft is imported by or on behalf of an operator for scheduled passenger and cargo operations[5]. This exemption should be available even in case of a sale and lease back structure, so long as the lessor already has a firm lease agreement with a scheduled operator. Alternatively, the carrier can import the aircraft as the 'importer on record' as the importer is not required to be the owner of the aircraft. For this, the lease should commence immediately prior to the import of the aircraft.

C. *Import of aircraft by Carrier*

Import of aircraft by Carrier, other than by way of lease will be subject to same rates as specified above – that is, BCD is exempt and Import of IGST will be chargeable at 5% of the value of the aircraft.

2.2.2. *Leasing of aircraft: Offshore and on-shore*

Under GST laws, **leasing of goods is deemed to be a service**[6]. Schedule II of the CGST Act, 2017 specifies activities which are to be treated as either supply of goods or supply of services. The relevant portion of Schedule II is provided below:

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[5]*Entry 540 of Notification 50/2017-Customs dated 30-06-2017 exempts import of aircraft from BCD if the importer satisfies certain specified conditions. The relevant extract is provided below:*

(i) imported by an operator or on behalf of the operator, for operating scheduled air transport service or scheduled air cargo service, and such aircraft is used for operating the scheduled air transport service or the scheduled air cargo service, as the case may be; or

(ii) the said aircraft is not registered or not intended to be registered in India, and brought into India for the purpose of a flight to or across India, and which is intended to be removed from India within fifteen days, or as extended by the competent authority in Ministry of Civil aviation, not exceeding sixty days, from the date of entry."

Explanation.- For the purposes of this entry,

(a) "operator" means a person, organisation or enterprise engaged in or offering to engage in aircraft operation;

(b) "scheduled air transport service" means an air transport service undertaken between the same two or more places and operated according to a published time table or with flights so regular or frequent that they constitute a recognizably systematic series, each flight being open to use by members of the public; and

(c) "scheduled air cargo service" means air transportation of cargo or mail on a scheduled basis according to a published time table or with flights so regular or frequent that they constitute a recognizably systematic series, not open to use by passengers.

[6]Entry 5(f) of Schedule II of the CGST Act

"5. Supply of services

The following shall be treated as supply of services, namely:—

(a)..

....

(f) transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration."

The place of supply for cross border leasing of aircrafts is deemed to be the location of the carrier[7]. Therefore, offshore lease transactions are subject to GST. GST is also applicable where the lease transaction is carried out in India.

Further, there is an inherent ambiguity on the applicable GST rate on leasing of an aircraft. There appear to be two entries under the GST tariff where such leasing services would be covered:

- ***Heading 9971 (i) of the GST Tariff (read with Notification 8/2017-Integrated dated 28.06.2017, read with Notification 11/2017-Central Tax(Rate) dated 28.06.2017):***

CHAPTER, SECTION OR HEADING	DESCRIPTION OF SERVICES	GST RATES			CONDITION
		CGST	SGST	IGST	
Heading 9971	(I) Transfer of right to use goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration	Same rate of central tax as on supply of like goods involving transfer of title in goods [Transfer of title (i.e. sale) of an aircraft above 2000 kgs and not purchased for personal use; as well as parts thereof, attracts CGST of **2.5%**]	Same rate of State/ union territory tax as on supply of like goods involving transfer of title in goods [Transfer of title (i.e. sale) of an aircraft above 2000 kgs and not purchased for personal use; as well as parts thereof, attracts SGST of **2.5%**]	Same rate of integrated tax as on supply of like goods involving transfer of title in goods [Transfer of title (i.e. sale) of an aircraft above 2000 kgs and not purchased for personal use; as well as parts thereof, attracts IGST of **5%**]	Nil

[7]Section 13(2) of the IGST Act

-Heading 9971 (v) of the GST Tariff (read with Notification 8/2017-Integrated dated 28.06.2017, read with Notification 11/2017-Central Tax(Rate) dated 28.06.2017)

CHAPTER, SECTION OR HEADING	DESCRIPTION OF SERVICES	GST RATES			CONDITION
		CGST	SGST	IGST	
Heading 9971	(v) Leasing of aircrafts by an operator for operating scheduled air transport service or scheduled air cargo service by way of transaction covered by clause (f) paragraph 5 of Schedule II of the Central Goods and Services Act, 2017. Explanation- (a) "operator" means a person, organisation or enterprise engaged in or offering to engage in aircraft operations; (b) "scheduled air transport service" means an air transport service undertaken between the same two or more places operated according to a published time table or with flights so regular or frequent that they constitute a recognisable systematic series, each flight being open to use by members of the public; (c) "scheduled air cargo service" means air transportation of cargo or mail on a scheduled basis according to a published time table or with flights so regular or frequent that they constitute a recognisably systematic series, not open to use by passengers.	2.5	2.5	5	Provided that credit of input tax charged on goods used in supplying the service has not been taken

As it may be seen, leasing of aircraft can be arguably covered under both the above entries which have the same GST rates (combined CGST+SGST rate, or, IGST rate = 5%). However, while one entry is conditional on credit of GST paid on goods not being taken [entry (v)], the other entry [entry (i)] has no such condition. As such, two interpretations may be possible:

(a) That the general entry (entry i) covering services in the nature of transfer of right to use goods (in other words, a lease transaction) would be the correct entry as this entry is more beneficial to the assessee. *In other words, the assessee is entitled to the concessional rate of 5% GST without fulfilling any specific conditions*.

(b) That the more specific entry applicable for leasing of aircrafts is applicable; and hence the 5% rate is conditional on fulfillment of certain conditions regarding not availing credits on goods used in supplying the service of leasing (discussed in detail below)

However, given that we are at a planning stage, we have taken a more conservative position that the more specific entry for leasing of aircrafts [entry (v)] would be applicable[8].

In respect of parts of aircrafts on the other hand, entry (iv) will not be applicable since this entry specifically covers only 'leasing of aircrafts'. Hence leasing of aircraft parts can be covered only under entry (ii), under which a 5% rate is applicable.

Credit to Indian leasing company

[8]Technically however, we are more in line with view (a). This is because even if the condition in entry (v) is not fulfilled, the transaction would revert to the base GST rate, which in this case is 5% as well.

As discussed above, two possible interpretations are possible in regard to the rate applicable for leasing of aircrafts. On a conservative basis, we have assumed that the more specific entry for leasing of aircraft would be applicable.

Given this, for the service of leasing, credit of Import IGST paid on import of the aircraft **cannot be taken**[9]. Entry 15 (iv) of Notification 8/2017-Integrated tax (Rate) dated 28-06-2017 stipulates that *leasing of aircrafts by an operator for operating scheduled air transport service or scheduled air cargo service by way of transaction covered by clause (f) paragraph 5 of Schedule II of the Central Goods and Services Act, 2017* is subject to IGST at the rate of 5%, provided that credit of input tax charged on goods used in supplying the service has not been taken.

Therefore, Import IGST paid on import of aircraft (otherwise than under a lease arrangement) will be an additional cost. Similarly, Import IGST paid on import of parts of aircrafts (if any) which are used to repair the aircrafts provided on lease, will be an additional cost.

However, as mentioned above, the condition of not availing credit of GST paid on goods does not apply in case of lease of aircraft parts as such. Therefore, Import GST paid on import of aircraft parts, can be set off against GST payable on lease of such parts (as such), and hence will not be an additional cost.

In contrast, there is no Import IGST cost on import of aircraft under an offshore lease. Accordingly, onshore lease is tax inefficient due to this reason.

2.2.3. Supply of air transport services by carrier

Supply of air transport services are subject to the following rates:

S. NO.	SERVICE	RATE	CONDITION
1.	Transport of passengers by air in economy class **(Economy Class Airline Services)**	5%	Input tax credit of GST paid on goods used for supplying service has not been taken
2.	Transport of passenger by air in other than economy class **(Non-Economy Class Airline Services)**	12%	No condition

Credit of GST paid on lease rentals for carriers

Entry 8(iii) of Notification No. 8/2017-Integrated Tax (Rate) dated 28-06-2017 stipulates that "Transport of passengers, with or without accompanied belongings, by air in economy class." is subject to IGST at 5%, provided that "credit of input tax charged on goods used in supplying the service has not been taken." Further, Entry 8(v) of Notification No. 8/2017-Integrated Tax (Rate) dated 28-06-2017 stipulates that "Transport of passengers by air, with or without accompanied belongings, in other than economy class." is subject to IGST at 12%, with no conditions.

Carriers are permitted to take input tax credit of GST paid on all input services used for supplying both Economy Class Airline Services and Non-Economy Class Airline Services. Therefore, GST paid on lease rentals (of both aircrafts and aircraft parts) is available as input tax credit which the carrier can offset against

[9]Notification 8/2017 Integrated tax (Rate) dated 28 June 2017 stipulates that the the service of leasing of aircrafts by an operator for operating scheduled air transport service or scheduled air cargo service is taxable at 5%, if credit of input tax is not availed.

their output GST liability[10]. Thus, GST paid on lease rentals would not be a cost for carriers, and therefore, there is no disadvantage of domestic leasing at this stage.

Carriers are however, not allowed to take credit of Import GST payable (to the proportion of sale of economy tickets vis a vis total turnover) when they purchase the aircrafts outright (i.e, when the aircraft is purchased from within India, or imported other than by way of lease by the carrier) as the input GST in this case, will be in the nature of GST on purchase/import of 'goods', and thus restricted by the condition in Serial No. 1 above. The same restriction applies in case of purchase/ import of aircraft parts directly by the carrier.

2.2.4. Sale of aircraft in India

Sale of aircrafts within India is subject to GST at 5%. This is not relevant to import of aircraft from outside India (implications of which are discussed above), but could be relevant in case of resale of the imported aircraft by the leasing company/ carrier (if imported directly by carrier).

2.2.5. Conclusion

Despite replacement of VAT/Service tax with GST, there continues to be an arbitrage between off-shore and on-shore lease transactions. An Indian lessor will be required to pay Import IGST at 5% on import of aircraft/ aircraft parts into India. However, Import IGST paid on aircraft/ aircraft parts cannot be used to offset GST on lease rentals, nor can it set-off against economy tickets in case the aircraft/ aircraft part is purchased directly by the Carrier. This represents a prohibitive cost for undertaking lease operations in India or import directly by carrier (for example, in situations where the carrier obtains financing to purchase aircraft in its own name). In contrast, carrier importing an aircraft/ aircraft parts under an *offshore* lease transaction is exempt from Import IGST (on import of aircraft).

Further, GST paid by the carrier on lease rentals is available as credit against the carriers output GST applicable on air transport services.

[10] This is contrary to the previous advice (shared with us) which suggests that GST on lease rentals cannot be offset by carriers

COMPARATIVE ANALYSIS OF CURRENT OFF-SHORE VS. ON-SHORE LEASING TRANSACTIONS			
ACTIVITY	OFF-SHORE LEASING[11]	ON SHORE IN IFSC	DIRECT IMPORT BY CARRIER (OTHER THAN BY OFFSHORE LEASE)
Import of aircraft / aircraft parts	BCD = Nil Import IGST = Not applicable, if imported by scheduled operator under lease	BCD = Nil; Import IGST @ 5%	BCD = Nil; Import IGST @ 5%
Lease of aircraft/ aircraft parts	IGST @ 5%	IGST @ 5%	Not applicable as there is no further on-shore leasing in this case
Credit of Import IGST for lessor	*Not applicable, as no Import IGST is paid*	*Not applicable, as no IGST is paid at the time of Import* *Credit of import IGST on import of parts can be taken if imported parts <u>leased as such</u>; but not if the parts are used by leasing entity to service/ repair the aircraft given on lease*	Not applicable as there is no further on-shore leasing in this case
Economy Class Airline Services	GST @ 5%	GST @ 5%	GST @ 5%
Credit of input GST i.e. • *IGST paid on lease rentals on aircrafts/ parts; in case of onshore leasing* • *Import IGST in case of direct import of aircraft/parts by Carrier (column 4)*	Available	Available	Not available to the proportion of total turnover represented by economy ticket sales
Total GST cost on the transaction	5% of airline fare (economy)/ 12% of airline fare (non-economy) (assuming no unutilized credit)	5% of import of aircraft + 5% of airline fare (economy)/ 12% of airline fare (non-economy)	5% of import of aircraft (less credit proportional to turnover of non-economy seats) + 5% of airline fare (economy)/ 12% of airline fare (non-economy)

[11] Jurisdiction of offshore lessor not relevant for GST implications

Appendix-2

Direct tax implications and comparative analysis

The comparative direct tax implications as on date, of an offshore and an IFSC onshore is summarized below. This table highlights the direct tax advantages of a lessor in Ireland vis a vis an IFSC lessor. It also highlights that being located in an IFSC brings a leasing company to a greater parity with an Irish lessor; however, some disadvantages still remain for the Indian shareholders/creditors of the Indian IFSC lessor.

INCOME	LESSOR BASED IN IRELAND	ON-SHORE LEASING IN INDIA	ON-SHORE LEASING WITHIN IFSC
Lease rentals	In India: Nil income tax; and In Ireland: Lessors are subject to a concessional tax regime i.e. 12.5% of net profits[12]	**Income tax:** 34.94% of net profits **MAT:** 21.34% tax rate since year 1 To summarize, the tax rate would range between 21.34% to 34.94% (refer Note 2)	**Concessional income tax:** Section 80LA of the Income-Tax Act, 1961 exempts an IFSC unit from income tax in the first 5 years; Tax rate is approx. 15% in the subsequent 5 years (refer Note 1) **MAT:** Section 115JB(7) of the Income-Tax Act, 1961 sets a 9% tax rate since year 1 (refer Note 2) To summarize, the effective tax rate would be 9%.
Interest income from investment in lessor entity	Investor's income taxable at 20%[13]	34.94% of the net profits for an Indian investor	34.94% of the net profits for an Indian investor
Dividends distributed by lessor	Exempt for lessor; shareholders could be taxed up to 20%	(i) 21% (of the amount distributed) on the lessor; and 10% on the Indian shareholder (foreign shareholder exempt)	Exempt for lessor; Indian shareholder could be taxed up to 10% (Section 115BBDA of the Income-Tax Act, 1961); Foreign shareholder is exempt

Note 1: Units set up under IFSC area are governed by a special tax regime. Entities in IFSC are exempt from income tax for initial period of 5 years. Thereafter IFSC units will be taxed at the rate of 50% of normal tax rate. Which means, effective tax rate for next 5 years on entity doing business in IFSC will be 17.34% (i.e. half of 34.94% which is a normal tax rate). Subsequently, the normal tax rate will apply to IFSC units.

Note 2: In case of a company, the income tax payable is higher of the following amounts:

(i) Tax as per the normal provisions of the Income-tax Act (i.e. 30% of net profits); or

(ii) 18% of book profits (also known as MAT)

Book profits means net profits of the company as per the accounting profit & loss account (it is further adjusted – however the adjustment is not relevant for the purposes of this analysis). MAT credit is available to a taxpayer to the extent 'tax paid under MAT' exceeds 'tax payable under the normal provisions of the Act had MAT not been there'.

[12] This is based on certain publicly available online data. Since we are not experts in Irish law, we request this to be confirmed by an Irish tax expert

[13] This is based on certain publicly available online data. Since we are not experts in Irish law, we request this to be confirmed by an Irish tax expert

As discussed above, in the initial years, profits earned by the IFSC is exempt from regular income tax (ignoring MAT). It would earn book profits during such period. Accordingly, IFSC units would be required to pay MAT, which is based on book profits. An IFSC unit is subject to a concessional MAT rate of 9%, instead of 18% for non-IFSC companies. Although a concessional rate has been prescribed, the 9% MAT rate leads to a cash flow issue for the IFSC unit. This is an issue for all IFSCs and the concessional rate of 9% has been provided after the government has deliberated on this point. Accordingly, it is slightly unlikely that the government would provide a further concessional rate only for aircraft leasing.

1. Potential options and comparative analysis

S. No.	PROPOSED SOLUTIONS	LEGISLATION/ AUTHORITY CONCERNED	ADVANTAGES	DISADVANTAGES
1.	**If set up as non-IFSC** Proposal to have a direct tax holiday regime in the lines of Sections 80IA, 80IB, 10AA, etc.	IT Act	Freed from the reliance of IFSC. It can be setup anywhere in India. To some extent, a precedent of the special tax holiday regime is available (for certain business provided in Sections 80IA, IB, 10AA, etc.).	MAT at 18.5%, and DDT at 21% would continue to apply. While an exemption on this could be sought, it is fairly unprecedented (except IFSC as discussed below). The special exemptions under income taxes are being phased out and the government has stated its intent to simplify the Income Tax Law with minimal carve-outs / exceptions.
2.	**If set up in IFSC** - Concessional tax on interest income - Exemption from MAT	IT Act read with SEZ Act and other regulations regarding IFSC (refer Part A)	The proposed changes could be made by making minor tweaks (with respect to concessional rate for interest/ MAT exemption) within the current income tax regime for IFSC as provided in detail in the Table below. This is recommended as it is easier to implement/ path of least resistance (and many of required tax benefits are already available to an IFSC as discussed in Table above)	Requirement to be located in the specified IFSC earmarked zones. However, since IFSC option is in any case, being explored, this is likely to be the path of least resistance and easiest to implement.

Conclusion

At this stage, suggested option is to utilize the regime already available for IFSC and get the leasing activities to be permitted specifically as discussed in Part A. This will almost align the tax implications prevalent on setting up a unit in Ireland (9% MAT vs 12.5% tax in Ireland). Further, the following benefits may be sought by tweaks in the existing laws (and not separate regimes):

- **Increase of period of 100% deduction 10 consecutive years, in a block of 15 years:** Practically, on account of high amount of tax depreciation that would be available on the cost of the aircraft(s) in the initial year under the Written Down Value method; the taxable profits (if at all any) of the leasing company in the initial 5 years is likely to be less; and will increase over time as the WDV of the aircraft becomes lower. Therefore, the extent of actual benefit represented by the 100% deduction is not likely to significant in this industry. We propose the current tax holiday to be made available for any block of 10 consecutive period years within the first 15 years of the operations of the Leasing Company in IFSC.

- **Interest:** The effective tax rate for resident lenders is 34.94% on the net profits from lending operations. There is a special tax regime for borrowings from offshore investors in case of a (i) foreign currency loan; or (ii) rupee denominated bond issued to a foreign portfolio investor. The tax rate in such regime is 5%. In the current context, in order to make the arrangement attractive, Interest paid by a Leasing Company in IFSC to any lender should be exempt from withholding tax requirement.
- **MAT:** To incentivize leasing companies to set up and start leasing operations in India, MAT should be exempted for aircraft lessors operating out of an IFSC for an initial period of 5 years from the date of the IFSC unit starting commercial operations, with such benefits ceasing for IFSC units set up after 2024
- **Capital gains on transfer of bonds in leasing entity:** Currently, capital gains exemption is only available to a non-resident in respect of transfer of specified bonds and derivatives listed in a stock exchange in an IFSC [section 47(viiiab)]. To encourage domestic lender participation; this exemption should be extended to resident investors in respect of bonds and other instruments held in a leasing company in an IFSC.
- **Capital gains tax on resale/transfer of aircrafts:** Currently sale/resale of aircrafts by a leasing company in an IFSC unit attracts capital gains tax. Any transfer above book value will attract short terms capital gains tax at full marginal rate (currently 34.9%). Capital gains tax should be exempted for such transfer of aircrafts by a Leasing Company in an IFSC unit.
- **Tax on dividend income of non-company shareholders:** This may not be a very significant factor as investors will mainly invest in bonds and other forms of debt in the leasing company. However, this is mentioned for sake of completeness. Even though DDT is not applicable on dividends paid by unit in IFSC; Individual (HNI) shareholders (in fact all shareholders except companies and specified investment trusts) are liable to additional tax on dividend (Additional Dividend Tax) at the rate of 10% for dividend income in excess INR 1 million. This Additional Dividend Tax is not exempt in case of dividends received from unit in IFSC. Therefore, a special exemption from Additional Dividend Tax may be considered in respect of dividends declared by a leasing company located in IFSC to promote investments by HNIs/ other no-company investors.

KEY BENEFITS TO INDIA

Aviation industry has continued to expand as one of the leading contributors to global economic prosperity, generating economic development, employment opportunities, driver for accelerating domestic and international trade, facilitating supply management and tourism. An efficient air cargo and logistics ecosystem can be also promote global competitiveness, drive the 'Make in India' initiative and reduce economic disparities across geographies. An efficient agro-exports air freight chain has the potential to increase farmers' income manifold, which can lead to a domino effect on the overall economy. Performance-wise, Indian airports are attaining top-slots and recognition worldwide.

The robust backdrop is driving new financier and investor participation from regions around the world. Since 1970s, the growth of airline leasing market has seen a tremendous change and continues to grow in both size and importance. With a view of the above, it is important to understand the ancillary benefits and advantages accruing from the aviation industry in terms of financing and leasing of the aircraft and engines.

Aircraft being flexible in deployment and being standardized as a product, provide for sturdy and stable cash flows in leasing aircraft via long-term aircraft dry leasing.

On gauging a measure of the regional economic impact of aviation, as per studies it is found that in Africa air transport supports 6.8 million jobs and USD 72.5 billion in GDP. Similarly, in Asia and Pacific region, the aviation industry has in recent decades become a success story that supports 28.8 million jobs and USD 626 billion in GDP. Furthermore, regions like Europe and North America have a mature, consolidated and a liberalized market when it comes to implementation of technology in aircraft operations. However, regardless of the geographical locations, aviation creates possibilities to empower the nations and its people by providing them access to improved livelihood, health care, educational opportunities, tourism and for the overall mobility of the populace. A study on India by ATAG in July 2016[1] found that India contributed 1.1% (US $ 30.1 billion) of global aviation GDP (US $ 2.7 trillion), and held 4% of global direct aviation jobs. In fact, 12% of global aviation generated jobs were in India (7.5 million out of 62.7 million).

Within India, this study found that the air transport market in India directly employed more than 390,000 people and supported another 570,000 more in the supply chain. Overall the industry contributed about USD 30 billion annually to India's GDP. A recent study by NCAER shows that in 2014-15, the direct output due to Delhi airport alone was ₹ 33,139 crore, value addition was US$ 1.23 billion, and it provided 1.06 lakh jobs. Capturing the total (direct, indirect and induced) impacts shows that the output of Delhi airport was ₹ 91,054 crore, value addition USD 4.83 billion, and it provided 6.08 lakh jobs. After capturing the catalytic impacts, the job creation was a huge over 39 lakh country-wide.

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[1]Aviation Benefits Beyond Borders, Powering Global Economic Growth, Employment, Trade Links, Tourism and Support for Sustainable Development through Air Transport, July 2016.

As the Working Group's focus has been on how the aircraft leasing industry in Ireland developed itself to reach global commanding heights, it is important to mention the prosperity that this industry has brought to that nation. Ireland is the major global player in the fast-growing, internationally focused aircraft leasing industry. A recent PwC study found that, excluding its tax contribution, the sector brings in an estimated US$ 660 million (€ 541 million) to the Irish economy and supports almost 5,000 direct and indirect jobs.

This is the massive scale of this Industry. It would not only benefit the economy but also attract the world's largest ancillary firms that provide financial consulting, accountancy and legal services to India with specialist aviation knowledge. However, with the welcoming of aircraft leasing companies to India it is of vital importance to invest in specialized industry education to ensure that Indian personnel have the skills to sustain this growth and secure India's leading position into the future.

If the aircraft financing and leasing industry is allowed to foster in an environment such as the IFSC in India, the flexibility of regulation needed in the industry for now will not have any effects on mainland regulations. Moreover, the IFSC is in a position to provide some of the best infrastructure and connectivity available anywhere else in the country. In addition to the IFSC being an area focused on financial services firms, the asset management and leasing companies will have access to multiple options for potential financiers of their projects. The airline industry in India is growing at double-digits per annum, now is the time to seize this opportunity and bring all the income benefits of this industry to the country and also facilitate skilled job growth to retain India's most talented professionals.

To summarize, the key benefits to India are as follows:

- Develop new line of business in India for International Financial Services.
- Create additional high-end jobs opportunities in India
- Retain International Financial Services business in India and general additional business for Banks, NBFCs, Credit Guarantors, Insurance companies, other ancillary business (law firms, accounting firms etc.)
- Add India on the map of global financial centres for International Financial Services
- Generate additional revenues through collection of taxes from ancillary industries and eventually through aircraft financing.
- Bring various foreign lessors in India.
- Reduce foreign exchange outgo (lease rentals, maintenance, legal/consultancy fee etc.)
- Foster an aviation financing system that supports financing of airport development as well as the Make-in-India initiative for manufacturing of aircraft, helicopters, drones, air taxis, and other forms of carriage, besides component and parts suppliers for Indian manufacturers of carriers as also global OEMs.

ANNEX I

No.AV-16011/2/2018-ER
Government of India
Ministry of Civil Aviation
....

"B" Block, Rajiv Gandhi Bhavan,
Safdarjung Airport, New Delhi
Dated: 22.05.2018

ORDER

Subject: Constitution of Working Group on Development of Avenues for Aircraft Financing and Leasing Activities in India

With the approval of the competent authority, it has been decided to set up a Working Group to formulate a road map for developing aircraft financing and leasing as an asset class from institutional investors in India.

2. Composition of the Working Group is as under:

SL. NO.	NAME	DESIGNATION
1.	Ms. Vandana Aggarwal, Economic Adviser (AS grade), M/o Civil Aviation	Chairperson
2.	Representative of Directorate General of Civil Aviation	Member
3.	Representative of D/o Financial Services	Member
4.	Representative of D/o Economic Affairs	Member
5.	Representative of D/o Commerce	Member
6.	Representative of D/o Corporate Affairs	Member
7.	Representative of Central Board of Indirect Taxes & Customs	Member
8.	Representative of Central Board of Direct Taxes	Member
9.	Representative of Reserve Bank of India	Member
10.	Shri Dipesh Shah, Head (IFSC & Strategy), Gujarat International Finance Tec City Corp. Ltd. (GIFT-City)	Member
11.	Shri Ajay Singh, Chairman, CII National Committee on Aviation	Member
12.	Shri Pratyush Kumar, Chairman, FICCI National Aviation Committee	Member
13.	Dr. Vinod Kothari, Vinod Kothari Consultants	Member
14.	Prof. Sanjay Sehgal, Head, Department of Financial Studies, University of Delhi	Member
15.	Ms. Purvi Maheshwari, Senior Director, Boeing Capital Corporation	Member
16.	Shri Angshumali Rastogi, Director, M/o Civil Aviation	Member Secretary

3. The Working Group may co-opt industry experts to the Working Group or invite them as Special Invitees to any meetings held by it on need basis under intimation to the Ministry.

4. The Terms of Reference of the Working Group will be as follows:

   (i) To examine the existing regulatory framework pertaining to banks, financial institutions (such as insurance companies) and high net-worth individuals, identify provisions that could potentially restrict an entity from being set up in the GIFT-City or elsewhere in India whose primary business is the undertaking of aircraft financing and aircraft leasing activities, and recommend changes thereto.

   (ii) To examine the existing aircraft financing and aircraft leasing activities of foreign entities with Indian airline operators and identify the regulatory and procedural issues, including with regard to direct and indirect taxes and other duties and import and re-export provisions, and recommend changes thereto along with potential strategies for making aircraft financing and aircraft leasing activities more attractive for entities set up in the GIFT-City or elsewhere in India.

   (iii) To examine any other issues emanating from applicable civil aviation policies and laws which may need to be addressed so that Indian entities are better enabled to seize the emerging opportunities arising for aircraft financing and aircraft leasing from the growth and development of the civil aviation sector.

5. The Working Group may also examine and address any other issues which are important though not specifically spelt out in TOR. The Working Group may devise its own procedures for conducting its business / meetings/ field visits/ constitution of subgroups etc.

6. The Working Group will be serviced by Ministry of Civil Aviation.

7. The Working Group will submit its report within 3 months of its constitution to the Ministry of Civil Aviation.

8. The first meeting of the Working Group is scheduled to be held on 23.05.2018 at 2:30 p.m., in accordance with the particulars of the meeting notice issued vide letter of even No. dated 21.05.2018. The meeting scheduled to be held on 24.05.2018 would be an exploratory meeting of some Members of the Working Group with insurance companies as per the meeting notice issued separately vide letter of even No. also dated 21.05.2018, and the proceedings of this meeting would be brought before the second meeting of the full Working Group.

9. The expenditure of the members on TA/DA in connection with the meetings of the Working Group or any work incidental to the functions of the Working Group will be borne by the parent Department/ Ministry/ Organization/ State Government for official members. The entitlements of Non-Officials of the Working Group would be as per O.M. No.19047/1/2016-E.IV dated 14.09.2017 issued by D/o Expenditure, M/o Finance.

(Angshumali Rastogi)
Director
Tel: 011-24653565
Email ID: angshumali.rastogi@gov.in

To:

1. The Chairperson and identified Members of the Working Group

2. The following **with a request to nominate an officer preferably in the rank of Joint Secretary to the Government of India well conversant with the subject:**

   (i) Director General of Civil Aviation, DGCA

   (ii) Secretary, D/o Financial Services

   (iii) Secretary, D/o Economic Affairs

   (iv) Secretary, D/o Commerce

   (v) Secretary, D/o Industrial Policy & Promotion

   (vi) Secretary, D/o Corporate Affairs

   (vii) Chairperson, Central Board of Indirect Taxes & Customs

   (viii) Chairperson, Central Board of Direct Taxes

   (ix) Shri B.P. Kanungo, Deputy Governor, Reserve Bank of India

Copy to:

1. PS to HMCA
2. PS to HMoSCA
3. PPS to Secretary (CA)
4. PPS to AS&FA
5. Guard File

ANNEX II

No.AV-16011/2/2018-ER
Government of India
Ministry of Civil Aviation
....

"B" Block, Rajiv Gandhi Bhavan,
Safdarjung Airport, New Delhi
Dated: 05.06.2018

ORDER

Subject: **Addendum to the Order dated 22.05.2018 constituting the Working Group on Development of Avenues for Aircraft Financing and Leasing Activities in India**

With the approval of the competent authority, it has been decided to add the following Members (at SI. Nos. 16 to 19) to the Working Group set up to formulate a road map for developing aircraft financing and leasing as an asset class from institutional investors in India:

SL. NO.	NAME	DESIGNATION
1.	Ms. Vandana Aggarwal, Economic Adviser (AS grade), M/o Civil Aviation	Chairperson
2.	Representative of Directorate General of Civil Aviation	Member
3.	Representative of D/o Financial Services	Member
4.	Representative of D/o Economic Affairs	Member
5.	Representative of D/o Commerce	Member
6.	Representative of D/o Industrial Policy & Promotion	Member
7.	Representative of D/o Corporate Affairs	Member
8.	Representative of Central Board of Indirect Taxes & Customs	Member
9.	Representative of Central Board of Direct Taxes	Member
10.	Representative of Reserve Bank of India	Member
11.	Shri Dipesh Shah, Head (IFSC & Strategy), Gujarat International Finance Tec City Corp. Ltd. (GIFT-City)	Member
12.	Shri Ajay Singh, Chairman, CII National Committee on Aviation	Member
13.	Shri Pratyush Kumar, Chairman, FICCI National Aviation Committee	Member
14.	Dr. Vinod Kothari, Vinod Kothari Consultants	Member
15.	Prof. Sanjay Sehgal, Head, D/o Financial Studies, University of Delhi	Member
16.	Ms. Purvi Maheshwari, Senior Director, Boeing Capital Corporation	Member
17.	Shri Vinod Hejmadi, Director (Finance), Air India	Member
18.	Shri Amit Agarwal, Deputy CEO & CFO, Jet Airways	Member
19.	Shri Krishan Bhargava, Vice President (Aircraft Financing), IndiGo	Member
20.	Shri Ajay Kumar, Partner, Rajinder Narain & Co.	Member
21.	Shri Angshumali Rastogi, Director, M/o Civil Aviation	Member Secretary

2. The Working Group may co-opt industry experts to the Working Group or invite them as Special Invitees to any meetings held by it on need basis under intimation to the Ministry.

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   (ii) To examine the existing aircraft financing and aircraft leasing activities of foreign entities with Indian airline operators and identify the regulatory and procedural issues, including with regard to direct and indirect taxes and other duties and import and re-export provisions, and recommend changes thereto along with potential strategies for making aircraft financing and aircraft leasing activities more attractive for entities set up in the GIFT-City or elsewhere in India.

   (iii) To examine any other issues emanating from applicable civil aviation policies and laws which may need to be addressed so that Indian entities are better enabled to seize the emerging opportunities arising for aircraft financing and aircraft leasing from the growth and development of the civil aviation sector.

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6. The Working Group will submit its report within 3 months of its constitution to the Ministry of Civil Aviation.

7. The expenditure of the members on TA/DA in connection with the meetings of the Working Group or any work incidental to the functions of the Working Group will be borne by the parent Department/ Ministry/ Organization/ State Government for official members. The entitlements of Non-Officials of the Working Group would be as per O.M. No.19047/1/2016-E.IV dated 14.09.2017 issued by D/o Expenditure, M/o Finance.

(Angshumali Rastogi)
Director
Tel: 011-24653565
Email ID: angshumali.rastogi@gov.in

To:

1. The Chairperson and identified Members of the Working Group

2. The following **<u>with a request to nominate an officer preferably in the rank of Joint Secretary to the Government of India well conversant with the subject:</u>**

   (i) Director General of Civil Aviation, DGCA

   (ii) Secretary, D/o Financial Services

   (iii) Secretary, D/o Economic Affairs

   (iv) Secretary, D/o Commerce

   (v) Secretary, D/o Industrial Policy & Promotion

   (vi) Secretary, D/o Corporate Affairs

   (vii) Chairperson, Central Board of Indirect Taxes & Customs

   (viii) Chairperson, Central Board of Direct Taxes

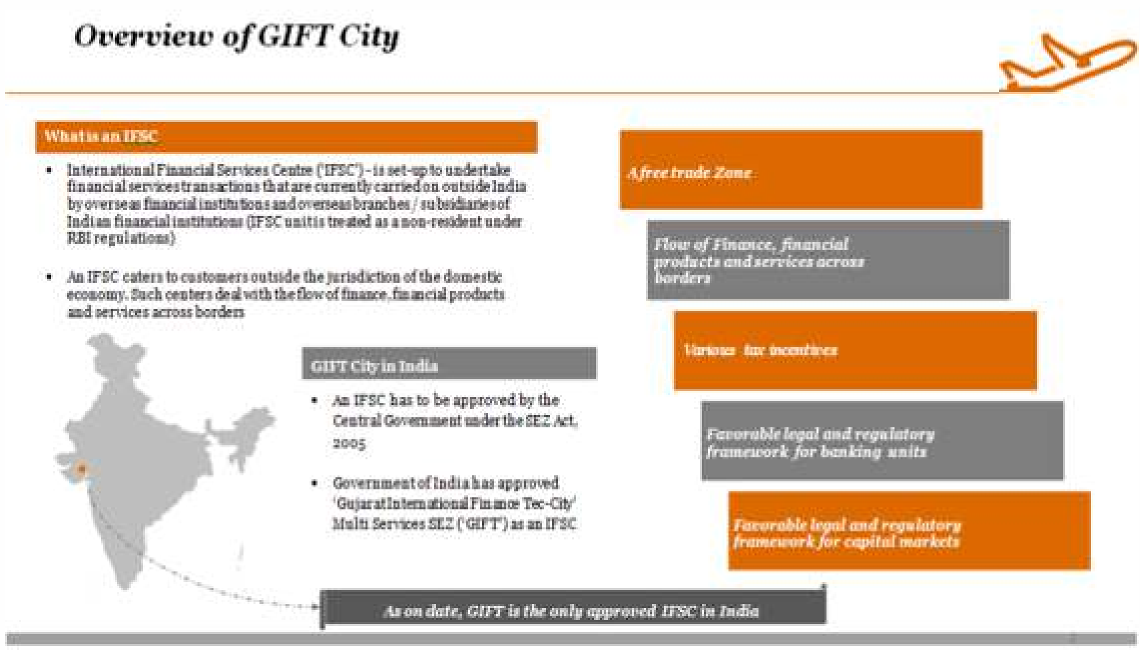
   (ix) Shri B.P. Kanungo, Deputy Governor, Reserve Bank of India

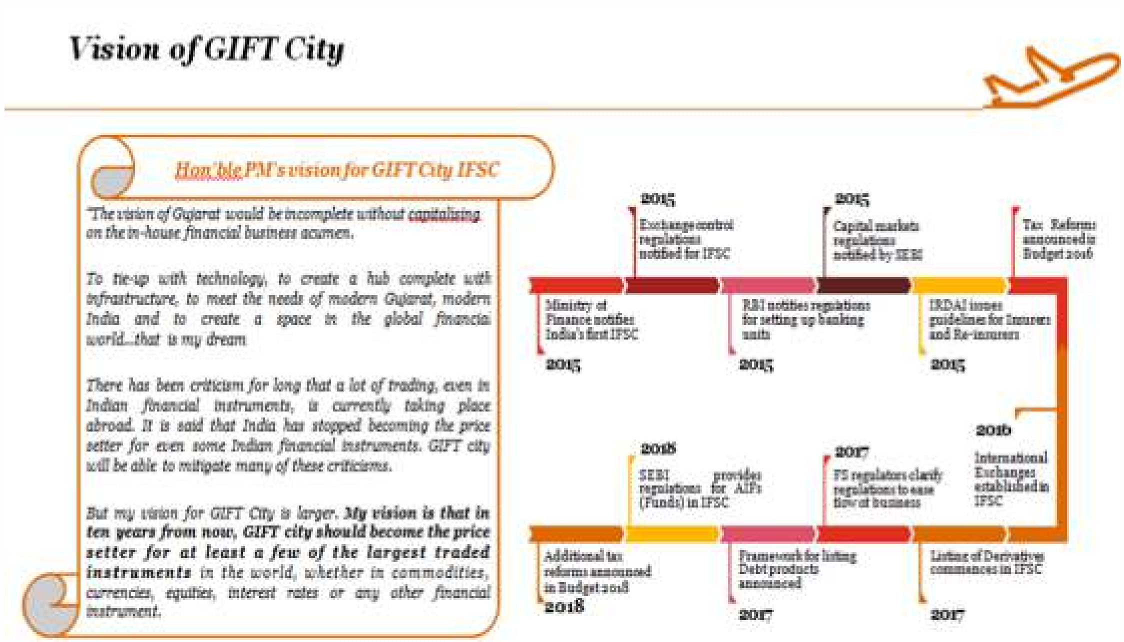
<u>Copy to:</u>

1. PS to HMCA
2. PS to HMoSCA
3. PPS to Secretary (CA)
4. PPS to AS&FA
5. Guard File

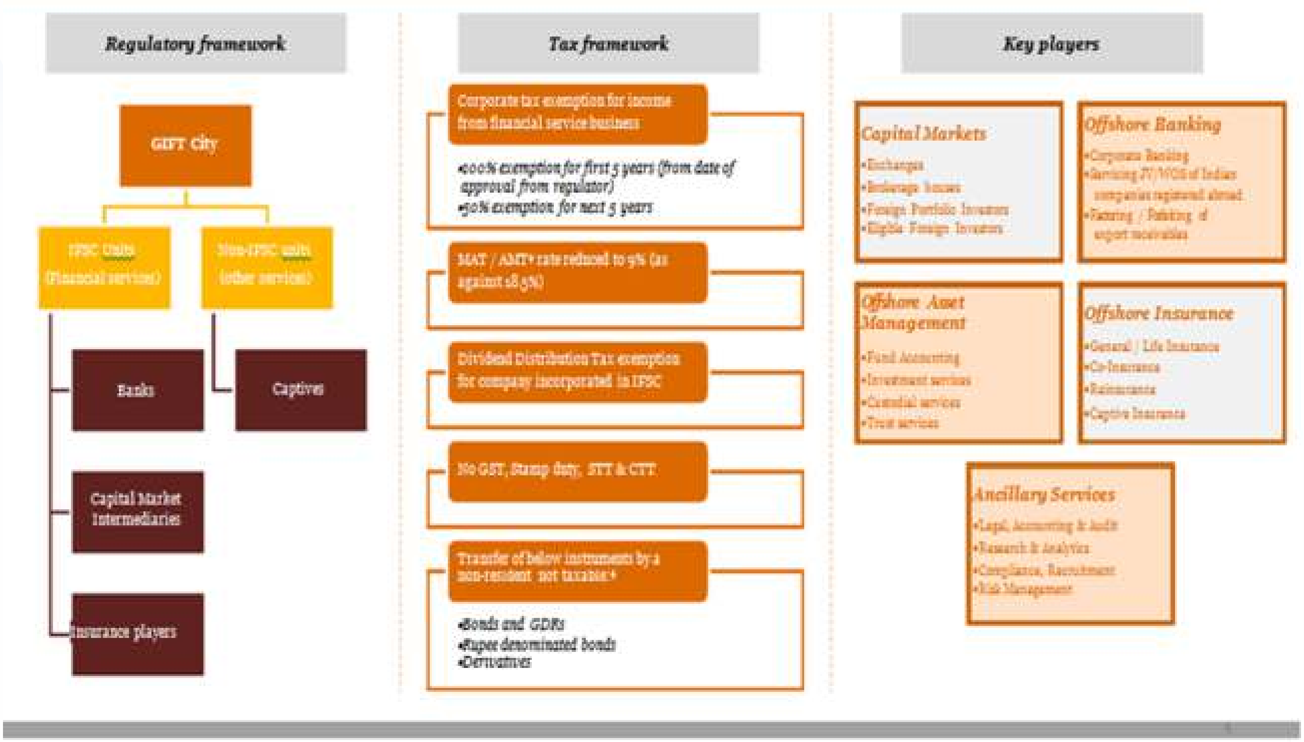
ANNEX III

Existing Regulatory and Tax Framework in GIFT-City IFSC





Vision of GIFT City



ANNEX IV

Comparative Tax Jurisdictions: GIFT-City IFSC vis-à-vis Major Centres

PARTICULARS	IRELAND	IFSC_INDIA	SINGAPORE	HONG KONG	CHINA
Corporate Tax Rate	12.5% (However group consolidation allowed)	Exemption available – 100% (First 5 years) and 50% (next 5 years) (However no group consolidation allowed) 34.96%	17% (reduced to 8% for income derived from aircraft leasing activities)	16.5% (reduced to 8.25% for qualifying aircraft leasing and leasing management companies)	25%
Minimum Alternate Tax for Lessor Company	Not applicable	Book profits subject to tax at 10.48%	Not applicable	Not applicable	Not applicable
Tax Depreciation Allowance	Allowed to depreciate the aircraft cost over 8 years.	Allowed to depreciate the aircraft for MAT computation over 20 years	Can depreciate the aircraft over any number of years from 3 to 20 years	Not applicable	10 years
Interest expense on aircraft loan/ intercompany funding	Deductible on arms-length payments	Deductible on arms-length payments	Deductible on arms-length payments	Deductible subject to fulfilment of certain conditions	Deductible on arms-length payments
Withholding Tax on interest payment by lessor SPV	20% (exemption available to payments to 'Qualifying lender') Typically would be 'zero' WHT	Interest to domestic parties – 10% Interest to non-residents – Typically 10/15%% in tax treaties	Nil	Not applicable	10% (Maybe reduced by applicable DTA)
Withholding Tax on lease rental paid to lessor	Nil	2%	10%	10%	10%
GST on lease rental payments by Indian Airlines	5%	5%	5%	5%	5%
Taxable base	Gross rentals less deductible expenses including depreciation allowance No taxability since significant tax depreciation allowance available	Gross rentals less deductible expenses including depreciation allowance No taxability under normal tax computation, however taxable on the book profits under MAT	Gross rentals less deductible expenses including depreciation allowance	20% (Gross lease rentals less allowable expenses excluding depreciation) Effective tax rate ~ 3%-4%	Gross rentals less deductible expenses including depreciation allowance
Disposal of aircraft	Taxable as business income to the extent of the original cost and excess gains taxable as capital gains	Being a depreciable asset, capital gains will be subject to 34.99% (approx.)	Nil	Not subject to tax on aircraft disposal after three years	Capital gains is taxed as part of operating income at 25%
Stamp Duty	Nil	Applicable	Nil	Nil	0.1% to 0.005% depending on nature of lease arrangement

ANNEX V

Financial Model to make domestic financing and leasing attractive to airlines, financiers and lessors/ asset managers located in India: Key Assumptions

PARTICULARS	KEY ASSUMPTIONS
Estimated purchase price (PP)	$50M
Useful life of aircraft	25 years
Lease term: First lease Subsequent leases	12 years 13 years
Pre delivery payment (assumed 40% of cost)	$20M
Annual lease rentals: First Lease (lease rate factor: 0.85%) Subsequent leases	$5.10M per annum $1.92M per annum
Debt : Equity	80 : 20
Expected return on equity	7.50%
Cost of Funding: $ denominated (80%/IFSC; 100%/Ireland)	4.50%
Rupee denominated (20% for IFSC)	10%
Currency hedging cost	5%
Operating expenses including lease management expenses	$0.75M per annum
MRO charges	$4M p.a. for first 12 years; $5M p.a. subsequent years
Depreciation Allowance (For accounting – 25 years)	For tax – 12.5% SLM (Ireland); 40% WDV (GIFT, India)
Sale value of aircraft at end of 12 years	$7.50M

ANNEX VI

Overview of Tax and Duties: Current Regime

PARTICULARS		IRELAND	IFSC-GIFT CITY	INDIA
INCOME-TAX				
Corporate tax rate	Year 1 to 5	12.50%	0.00%	34.94%
	Year 6 to 10		17.47%	
	From year 11		34.94%	
Minimum Alternate Tax	MAT	0.00%	10.48%	21.55%
Capital gains tax on sale of aircraft	CGT	33.00%	34.94%	34.94%
WHT on operating lease rentals	WHT	0.00%	2.00%	2.00%
WHT on interest payments (USD debt)	WHT	0.00%	5.46%	5.46%
WHT on interest payments (INR debt)	WHT	NA	0.00%	0.00%
WHT on other payments (Lease mgmt., MRO)	WHT	0.00%	10.00%	10.00%
Dividend distribution tax	DDT	0.00%	Nil	20.56%
GOODS AND SERVICES TAX				
GST on purchase of aircraft	GST	0.00%	0.00%	0.00%
GST on operating lease rentals	GST	5.00%	5.00%	5.00%
GST on finance lease payments	GST	5.00%	5.00%	5.00%
GST on other services	GST	0.00%	0.00%	18.00%
Stamp duty on lease related documents	As provided	0.00%	2.00% (Sale/Lease)	3.00% (Sale); Negligible (Lease)

Overview of Tax and Duties: Proposed Regime

PARTICULARS		IRELAND	GIFT City	INDIA
INCOME-TAX				
Corporate tax rate	Year 1 to 5	12.50%	0.00%	34.94%
	Year 6 to 10		17.47%	
	From year 11		34.94%	
Minimum Alternate Tax	MAT	0.00%	10.48%	21.55%
Capital gains tax on sale of aircraft	CGT	33.00%	0.00%	34.94%
WHT on operating lease rentals	WHT	0.00%	0.00%	2.00%
WHT on interest payments (USD debt)	WHT	0.00%	0.00%	5.46%
WHT on interest payments (INR debt)	WHT	NA	0.00%*	0.00%*
WHT on other payments (Lease mgmt., MRO)	WHT	0.00%	0.00%	10.00%
Dividend distribution tax	DDT	0.00%	Nil	20.56%
GOODS AND SERVICES TAX				
GST on purchase of aircraft	GST	0.00%	0.00%	0.00%
GST on operating lease rentals	GST	5.00%	0.00%	5.00%
GST under finance lease (interest portion)	GST	5.00%	0.00%	5.00%
GST on other services	GST	0.00%	Nil	18.00%
Stamp duty on lease related documents	As provided	0.00%	0.00%	3.00%

Overview of Tax and Duties: Implications of Current Versus Proposed Review

(Amounts in USD Million)

Current regime

Particulars	Ireland	GIFT City	India
Scenario 1 – Aircraft is sold at the end of 12th year			
Income-tax costs (including WHT)	-	$ 5.27 M	$ 8.24 M
GST (operating lease rentals)	$ 3.06 M	$ 3.06 M	$ 3.06 M
Stamp Duty (lease agreement)	-	$ 0.25 M	$ 0.23 M
Total tax costs	**$ 3.06 M**	**$ 8.58 M**	**$ 11.52M**
Scenario 2 – Aircraft is fully used for 25 years			
Income-tax costs (incl. WHT)	-	$ 3.99 M	$ 7.54 M
GST (operating lease rentals)	$ 4.31 M	$ 4.31 M	$ 4.31 M
Stamp Duty (lease agreement)	-	$ 0.14 M	-
Total tax costs	**$ 4.31 M**	**$ 8.45 M**	**$ 11.85 M**

Proposed regime

	Ireland	GIFT City	India
Scenario 1 – Aircraft is sold at the end of 12th year			
	-	$ 0.65 M	$ 8.24 M
	$ 3.06 M	-	$ 3.06 M
	-	-	$ 0.23 M
	$ 3.06 M	**$ 0.65 M**	**$ 11.52 M**
Scenario 2 – Aircraft is fully used for 25 years			
	-	$ 1.44 M	$ 7.54 M
	$ 4.31 M	-	$ 4.31 M
	-	-	-
	$ 4.31 M	**$ 1.44 M**	**$ 11.85 M**

ANNEX VII

IATA

INDIA'S AIR TRANSPORT SECTOR

THE FUTURE IS BRIGHT . . .
BUT NOT WITHOUT ITS CHALLENGES

PREFACE

In a country where train travel has long been the dominant mode of transport, India's aviation sector has increasingly established itself as a safe, affordable and credible alternative. The number of passengers flown by Indian airlines has more than doubled over the past seven years, compared with just a 6% rise in railway passengers[1].

Moreover, as the world's largest democracy with a population of more than 1.3 billion citizens, India's potential for further growth and industry development is very clear. Indeed, we expect air passenger numbers to, from and within India to increase by 3.3x over the next 20 years, to more than 500 million passenger journeys per year.

This significant expansion is expected to be underpinned by a trebling in the proportion of middle-class households and further increases in time-saving options for air passengers. This highlights the important role aviation can play in connecting the country – both internally and with the rest of the world.

This strong growth outlook for air passenger demand will see India overtake Germany, Japan, Spain, and the UK within the next 10 years to become the world's third largest air passenger market.

These are exciting times for the air transport industry in India.

Of course, the future will not be without challenges – for those in the industry and policy-makers and regulators alike. These challenges will include making sure that the right type of infrastructure is put into place, at the right time and in the right location to ensure that the demand can be met, as well as ensuring that the regulatory environment is one which successfully fosters a competitive and healthy airline transport sector that will continue to make a major contribution to the Indian economy in the years to come. A robust and financially sound industry is critical to delivering the benefits that aviation can bring – creating jobs, bringing families together, facilitating business, and supporting trade, investment and economic growth.

Events such as this International Aviation Summit show that the importance of the industry is well-understood in India and underscores the initiatives that are already being taken to position the country for the key role it will increasingly have in global aviation leadership. It is my pleasure to contribute this assessment to the Summit.

Brian Pearce
Chief Economist
International Air Transport Association

Geneva
August 2018

[1]http://www.indianrailways.gov.in/railwayboard/uploads/directorate/stat_econ/IRSP_2016-17/Facts_Figure/Fact_Figures%20English%202016-17.pdf

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India's air transport industry; a global perspective

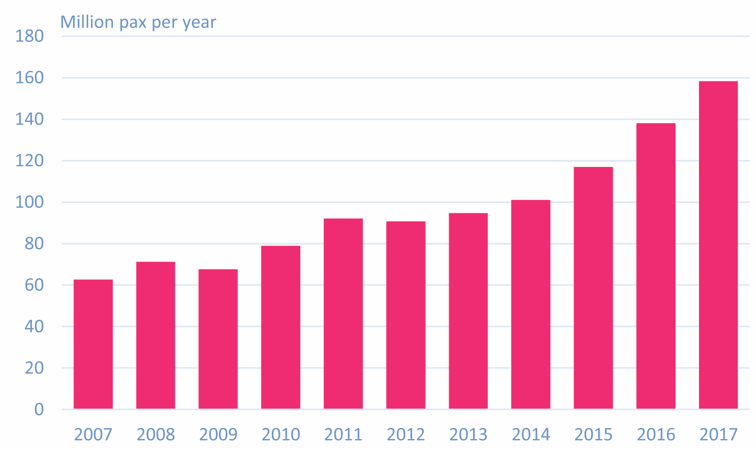
- The Indian air transport sector has shown very strong growth in recent years – particularly on the domestic market segment.
- In June 2018, the domestic India market recorded its 46th consecutive months of double-digit year-on-year growth; an outstanding performance and one which is showing no signs of ending anytime soon.
- The air transport market in India employs more than 390,000 people and supports another 570,000 more in the supply chain. Overall the industry contributes some US$30 billion annually to India's GDP.
- The fundamental drivers of air passenger demand – including population and demographics and increasing incomes – are favorable and supportive of ongoing growth over the longer-term.
- Over the next 20 years IATA forecasts growth of 6.1% per year on average – the number of annual air passenger journeys is forecast to increase by more than 350 million over the period, moving to almost 520 million journeys in 2037.
- The industry must continue to work constructively with its key stakeholders – including the government and policy-makers – to ensure that this sizeable increase in demand can be met and to realise the full benefits that the air transport industry can deliver to India.

Recent developments

In 2017, more than 158 million passengers flew on routes to, from and within India (Figure 1). This represents an increase of almost 15% over 2016 and is the third consecutive year of growth in the order of 15-20% per year (Figure 2).

The figures for the 2018 year-to-date suggest that India is on track to record a fourth straight year of double-digit passenger growth.

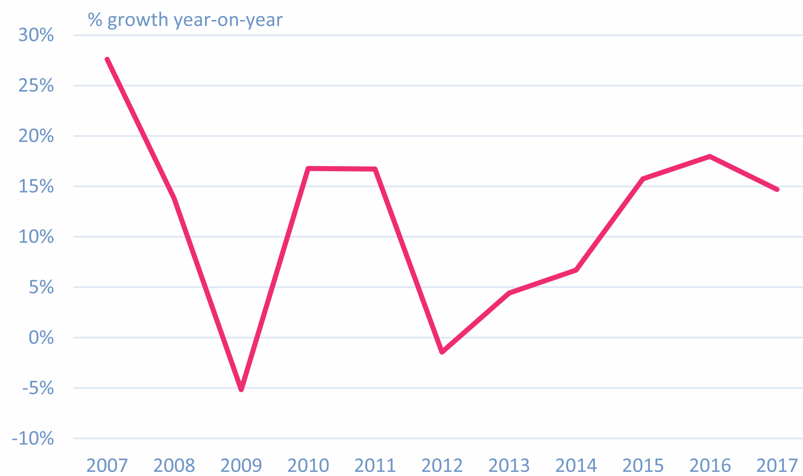
Figure 1: Total air passenger journeys to, from & within India (annual)[2]



Source: IATA

[2]Unless stated otherwise, all data in this report are calculated on an origin-destination (O-D) basis.

Figure 2: Annual growth in India's O-D air passenger journeys



Source: IATA

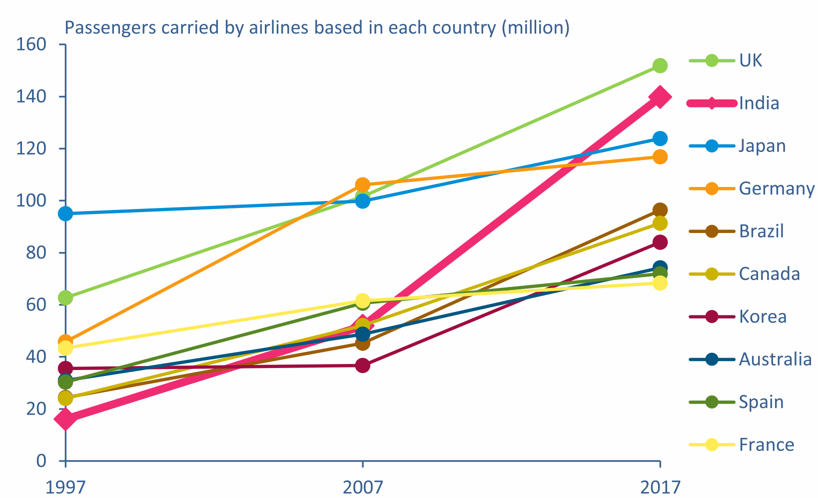
The strong performance of air passenger demand growth in India has not been confined to just the past few years, however; the total number of air passengers has more than doubled over the past seven years, from a level of 79 million journeys undertaken in 2010.

Indeed, utilising data from the World Bank and ICAO, which measures the number of passengers carried by airlines based in the particular country, we can see the growth of the Indian market in a longer-term perspective (Figure 3, over).

From flying just 16 million passengers 20 years ago, Indian airlines have seen their passenger volumes increase more than 8-fold in the period since. Along the way, India has overtaken a host of countries, including Germany and Japan, in the process.

Placed in this longer-term context, the relative performance of the air transport industry in India is stark.

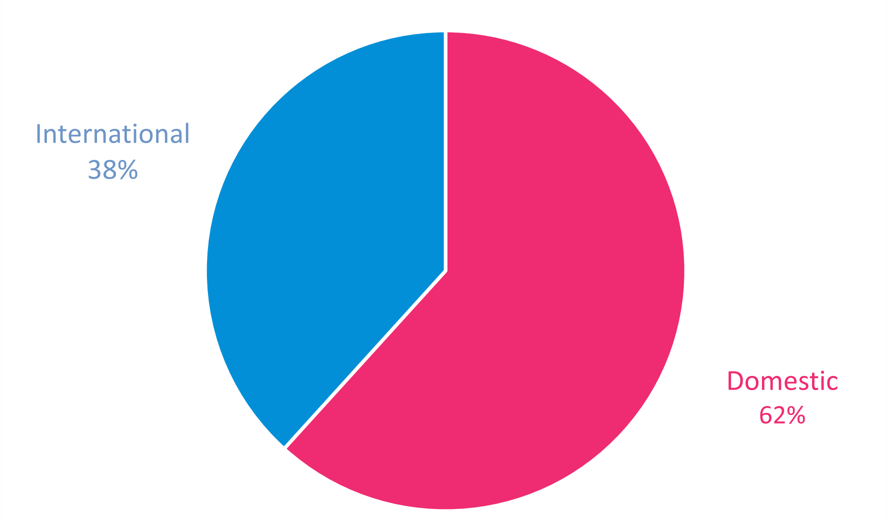
Figure 3: Increases in air passenger demand, 1997-2017, selected countries



Source: World Bank, ICAO

Returning to more recent outcomes, it is unsurprising to note that the bulk of the flights taken in 2017 were domestic in nature, accounting for around 62% of the total (Figure 4).

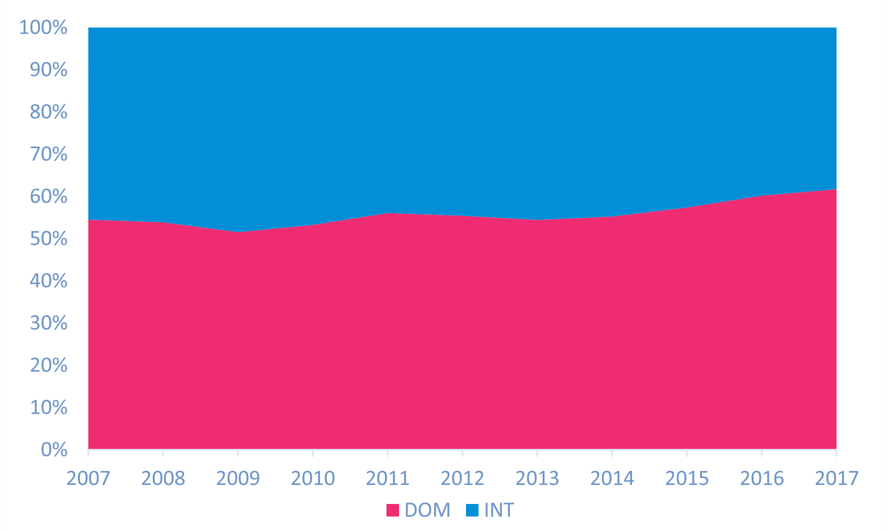
Figure 4: Composition of 2017 air travel: Domestic vs International



Source: IATA

Indeed, the domestic share of total traffic has been generally increasing gradually over the past decade. From 54.5% in 2007, and notwithstanding some bumps along the way, the domestic share has gradually risen to the 61.7% level of 2017 (Figure 5).

Figure 5: Evolution of market share: Domestic vs International

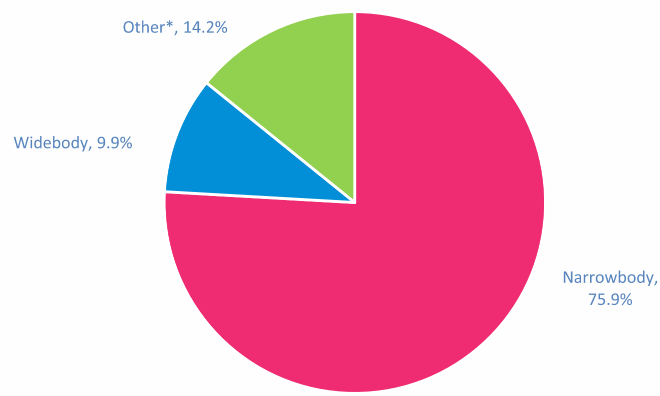


Source: IATA

Reflecting the relative size of the domestic and international markets, the composition of the current in-service fleet is heavily tilted towards narrowbody aircraft.

Narrowbodies account for ¾ of the total current fleet, with widebodies contributing a further 10%. The remainder consists primarily of turboprops and regional jet aircraft (Figure 6).

Figure 6: Composition of India's current aircraft fleet



*Source: CAPA * incl turboprops and regional jets*

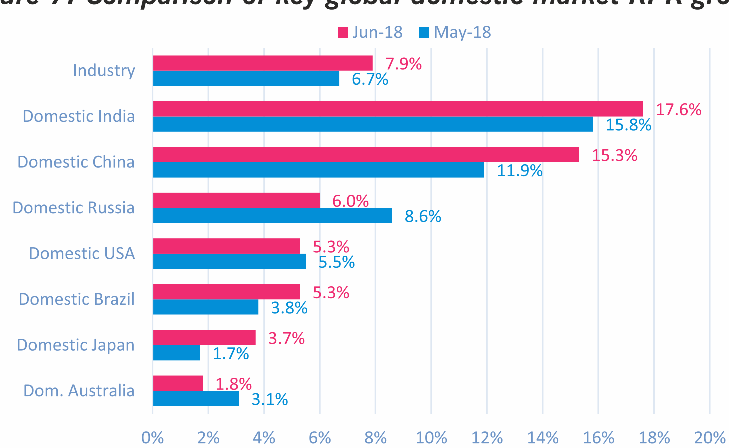
The following sections investigate the recent performance and key developments for the domestic and international market segments in turn.

India's Domestic air transport market

The India domestic market is currently the fastest growing (measured in in terms of revenue passenger kilometres[3]) of the main domestic markets that IATA consistently track around the world.

Over the year to June 2018, the India domestic market has grown by a very strong 17.6%, well above the industry-wide (domestic markets) pace of 7.9% (Figure 7).

Figure 7: Comparison of key global domestic market RPK growth



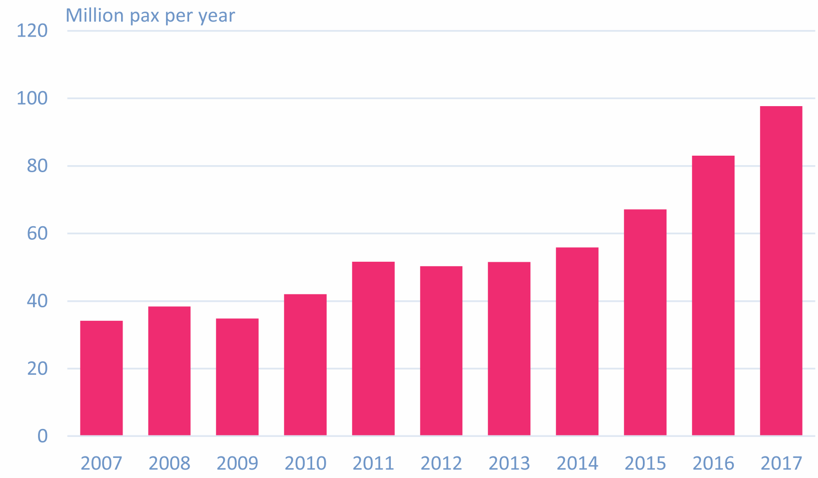
Source: IATA

[3]Revenue passenger kilometres (RPKs) is a measure of the volume of passengers carried by an airline. An RPK is flown when a revenue (paying) passenger is carried one kilometre.

June 2018 was the 46th consecutive month of double-digit growth in India domestic passenger volumes, fast closing in on the four year milestone.

In 2017, there were a total of 97.7 million domestic passenger journeys, up almost 15 million from 83 million in 2016 (Figure 8).

Figure 8: Number of origin-destination air passenger journeys per year – India Domestic



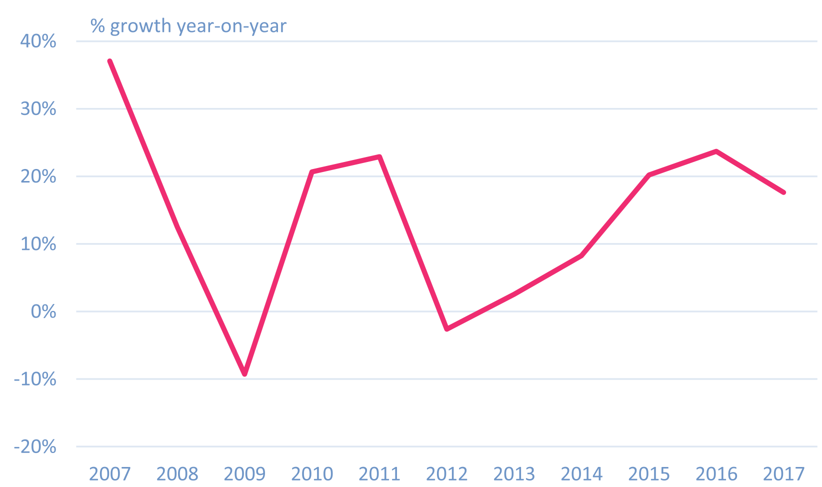
Source: IATA

Growth in the India domestic market has been faster than that of the total market depicted previously in Figure 2.

Following two lean years in 2012 and 2013 (in part reflecting the demise of Kingfisher), growth has recovered strongly.

In both 2015 and 2016, India domestic RPKs grew by more than 20% and in 2017, although the pace of growth eased moderately, it still recorded a very strong 17.6% rate (Figure 9).

Figure 9: Annual growth in origin-destination passenger journeys – India Domestic



Source: IATA

While such rapid growth cannot continue indefinitely, equally, there are no indications that the performance is likely to come to an abrupt end anytime soon.

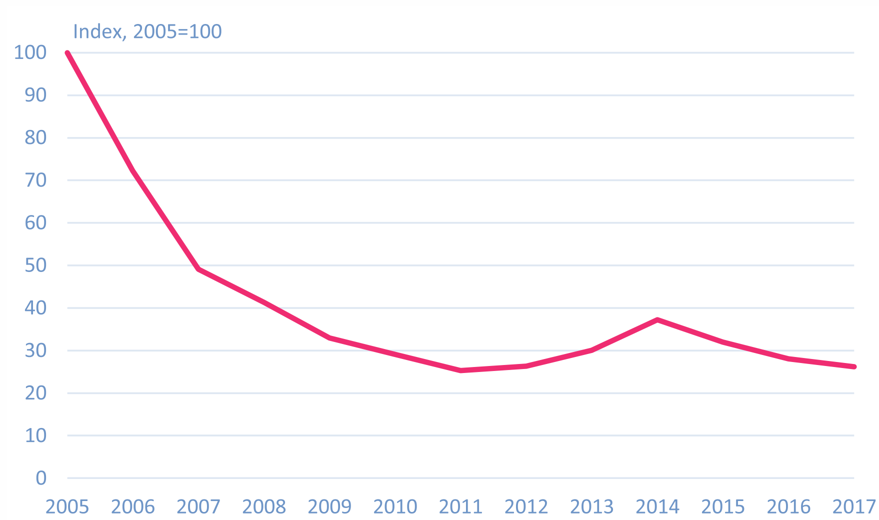
Highlighting this point, and the magnitude of the potential growth in the India domestic market, the number of domestic journeys undertaken in 2017 represents just 7.3% of India's total population.

The strong demand outcomes over recent years have been partly due to the stimulus of lower airfares.

In real (inflation-adjusted) terms, the average cost of an India domestic airfare has been trending lower for more than a decade.

After rising in 2013 and 2014 which, again, in large part reflects the impact of the market disruption associated with the demise of Kingfisher, the downwards trend has since resumed.

Figure 10: Average India Domestic airfare, adjusted for inflation



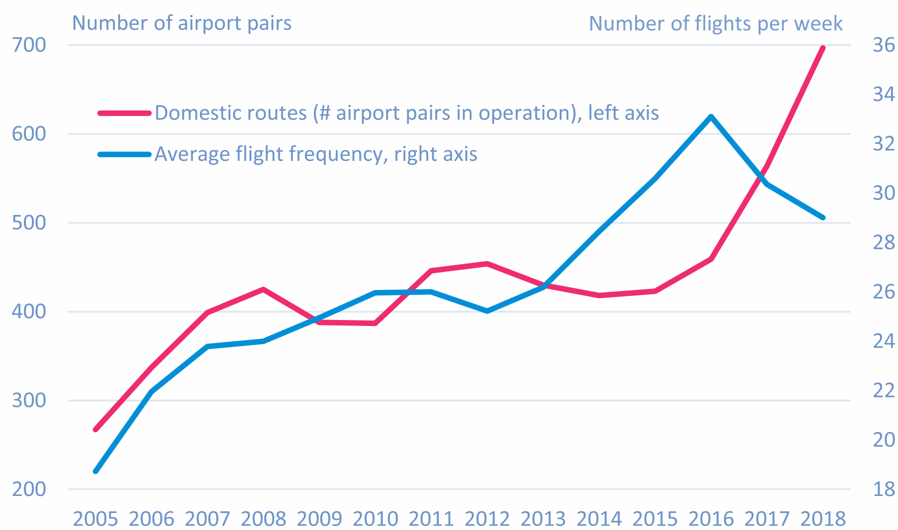
Source: IATA

India domestic passenger demand is also being driven in part by rapid expansion in the domestic air network.

This is evident both in terms of a strong rise in the number of airport pairs in operation within India – these have risen by more than 50% since 2015 – as well as increases in the average frequency of flights on each route (Figure 11).

Both of these factors ultimately translate into time savings for passengers and therefore have similar stimulatory impacts on demand as reductions in air fares.

Figure 11: Components of India's domestic air network growth: new routes vs increased frequency*

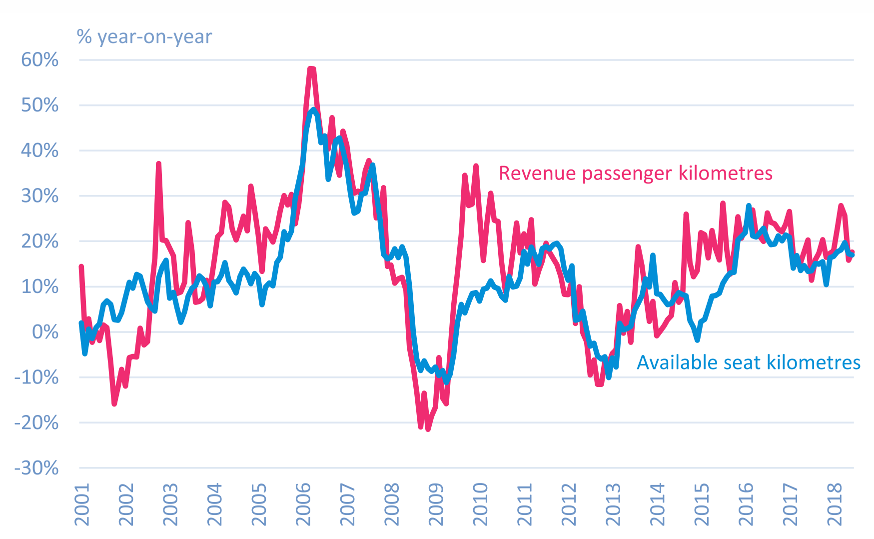


*Source: SRS Analyser * aircraft >19 seats, at least 1 flight per week on average*

Overall, India domestic demand (measured by RPKs) have grown faster than the corresponding rate of capacity growth (measured by available seat kilometers or ASKs) in recent years.

While the degree of outperformance has moderated from that seen in late-2014 and early-2015, annual RPK growth has still exceeded that of ASK growth by 3 percentage points on average each month over the past two years (Figure 12).

Figure 12: India Domestic– passenger demand (RPKs) and capacity (ASKs)

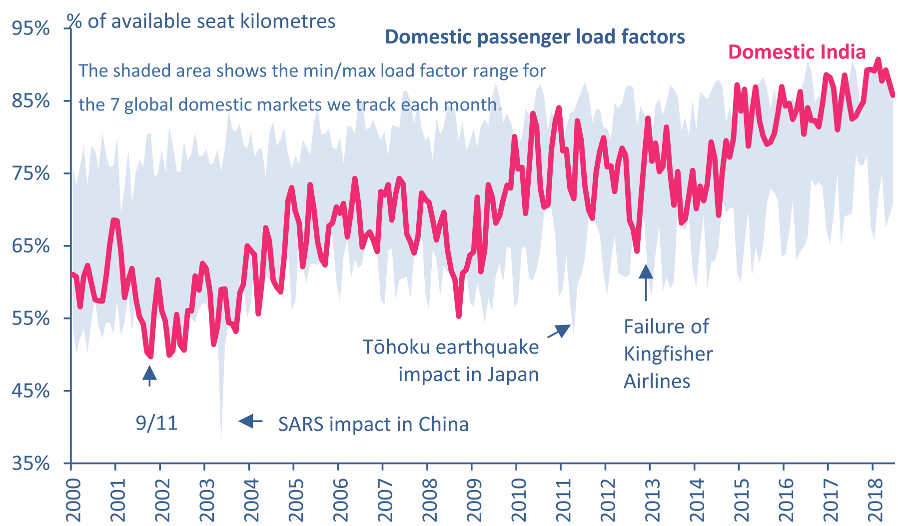


Source: IATA

Against this backdrop of developments in demand and capacity, the India domestic passenger load factor remains elevated.

Indeed, in February 2018, it exceeded 90% for the first time ever, hitting an all-time high for the seven global domestic markets[4] that we track each month (Figure 13).

Figure 13: Domestic India – passenger load factor performance



Source: IATA

The bigger picture is that the current load factor performance represents a significant turnaround from the early-2000s when India regularly posted the lowest domestic passenger load factor amongst our group of countries, even dipping below 50% on occasion.

The evolution and maturity of India's domestic air transport market can be illustrated by comparing the experiences around the time of 9/11 with that of late 2014.

In the former, domestic capacity continued to increase even as demand slumped, while in late-2014 Indian airlines slowed capacity growth to support the load factor even as demand was growing strongly.

In part this appears to reflect the increasing influence of competitive (market) pressures over time via a mix of policy, regulatory and industry developments.

Such forces have instilled a greater focus on airlines to achieve the load factor levels needed to generate adequate returns for their investors.

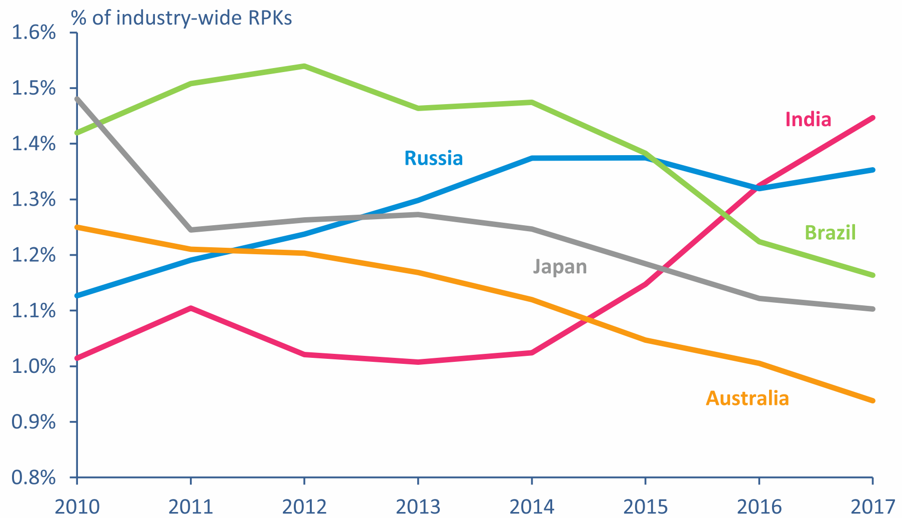
[4] India, China, the US, Brazil, Russia, Japan and Australia.

Figure 14 puts the strong and sustained growth performance of the India domestic market into a global perspective.

Since 2014, in terms of RPKs flown India has overtaken Australia, Japan, Brazil, and Russia – all of the main domestic markets that we follow, with the exception of China.

The India domestic market now accounts for around 1.5% of total industry-wide RPKs and is larger than all of the domestic markets that we follow, with the exception of China and the US.

Figure 14: Main global domestic air transport markets, share of industry-wide RPKs



Source: IATA

Furthermore, of the 100 largest domestic city pair routes in the world in 2017, ten can be found in India (Figure 15).

Figure 15: Largest city-pair routes Within India & their 2017 global ranking

		#pax 2017	YoY growth	Global rank
1	Mumbai-Delhi	5,566,510	1.9%	7
2	Bangalore-Delhi	3,492,889	-1.5%	20
3	Bangalore-Mumbai	2,716,801	3.0%	35
4	Kolkata-Delhi	2,153,297	5.6%	52
5	Delhi-Pune	1,997,165	17.5%	63
6	Delhi-Hyderabad	1,891,240	3.8%	75
7	Delhi-Chennai	1,836,447	-5.4%	80
8	Mumbai-Goa	1,748,145	-0.2%	89
9	Mumbai-Chennai	1,717,468	5.1%	91
10	Delhi-Goa	1,692,230	23.6%	96

Source: IATA WATS

In a similar way, of the top 10 growth airports in terms of passengers handled in 2017, two are located in India, namely Delhi and Bangalore (Figure 16).

In terms of global rankings, Delhi is #16 globally in terms of passengers handled and Mumbai is #29.

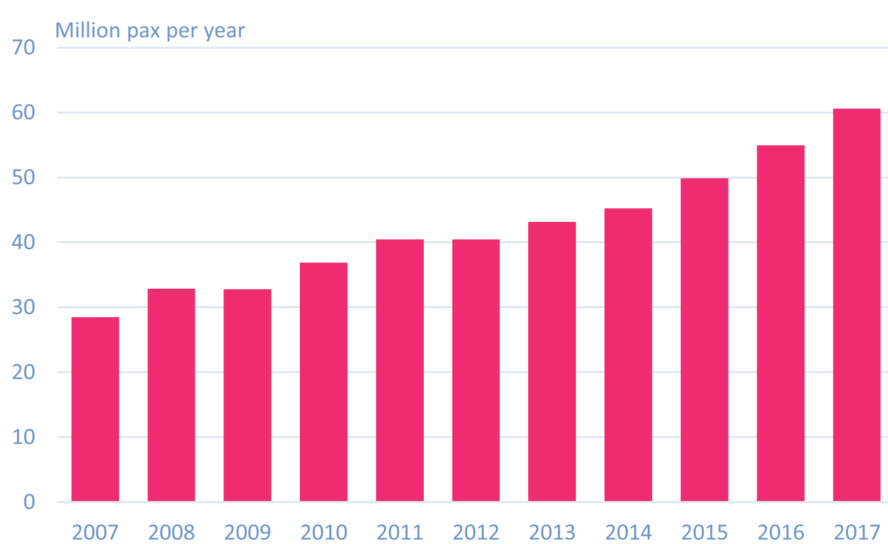
Figure 16: World's top ten growth airports 2017 – passengers handled

Source: ACI, IATA WATS

India's International air transport market

In 2017, around 60 million international passengers flew to/from India, up from 55 million in 2016 (Figure 17).

Figure 17: Number of origin-destination air passenger journeys per year – India International

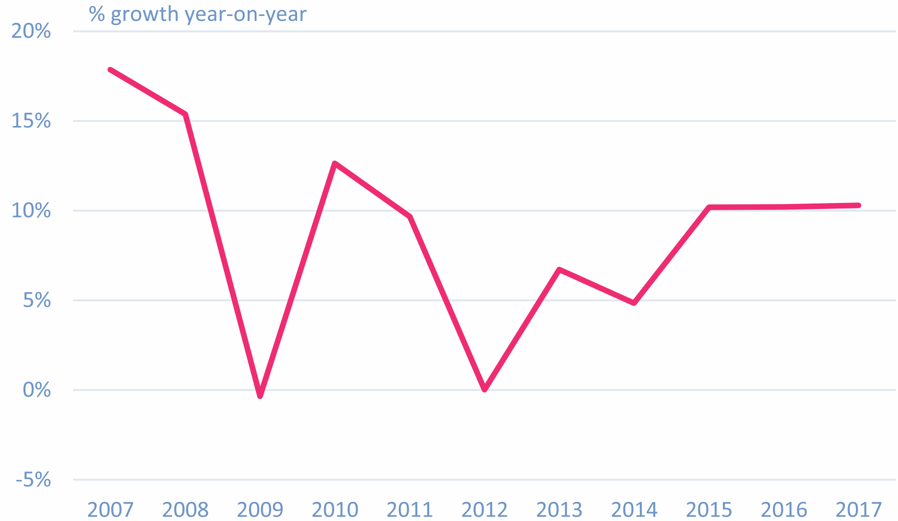


Source: IATA

While the international market has not grown as fast as its domestic counterpart, the sustained period of robust growth, over a number of years, is still readily evident.

The 2017 outcomes represents an increase of 10.3% on 2016 and is the third consecutive year of double-digit international passenger growth (Figure 18).

Figure 18: Annual growth in origin-destination passenger journeys – India International

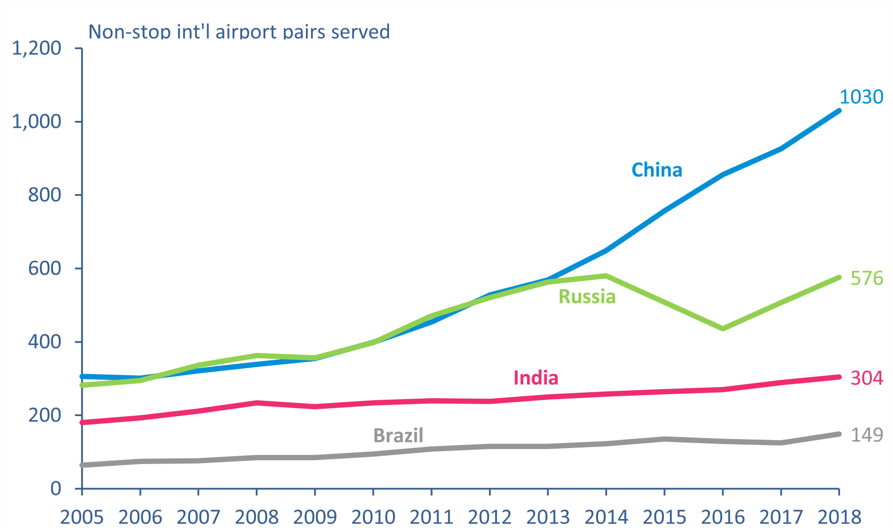


Source: IATA

Contributing to this growth performance, India has steadily increased the number of overseas city pairs served by a non-stop service from the country over time (Figure 19).

In 2018, there are 304 such international pairs, up from around 230 ten years ago.

Figure 19: Non-stop international city pairs served, selected countries



Source: IATA, SRS Analyser

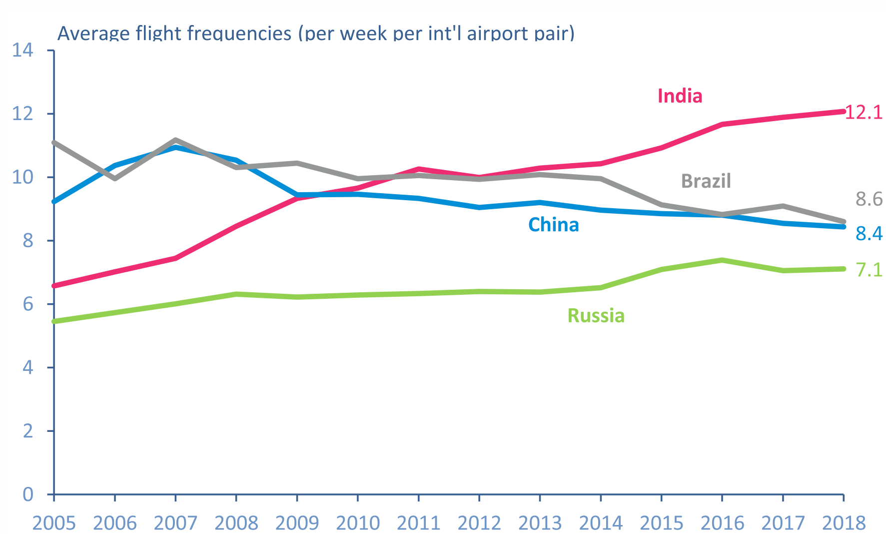
In relative terms, the India market appears to have considerably less international city pairs served than either China or Russia.

However, Indian travelers have ready access (via the geographic proximity) to the Middle East super-connector hubs – Dubai, Abu Dhabi and Doha – that China and Russia do not.

This increases the size of the network significantly for Indian travelers, as well as making India more accessible for international visitors. As such, it may go some way to explaining the relatively lower number of international city pairs for India relative to China and Russia.

As was the case for the India domestic market, at the same time as the number of international city pairs has been increasing, so too have the average number of flights on the international city pair routes (Figure 20).

Figure 20: Average flight frequencies on international city pairs served, selected countries



Source: IATA, SRS Analyser

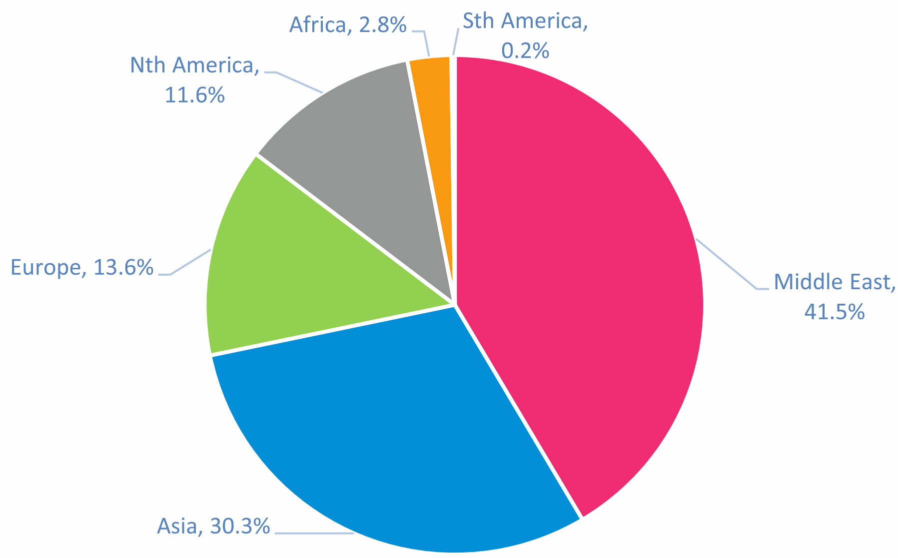
In contrast to both China and Russia, India is well served by the frequency of flights on the international markets served.

India has almost four additional frequencies per week on average between the airport pairs compared with both Russia and China.

A choice of flight times is particularly important for business travelers who value the flexibility the additional frequencies provide.

The bulk of international traffic is to the Middle East and Asian destinations, with these two markets accounting for around 70% of the total share of international traffic from India in 2017 (Figure 21).

Figure 21: Share of international traffic by continent, 2017

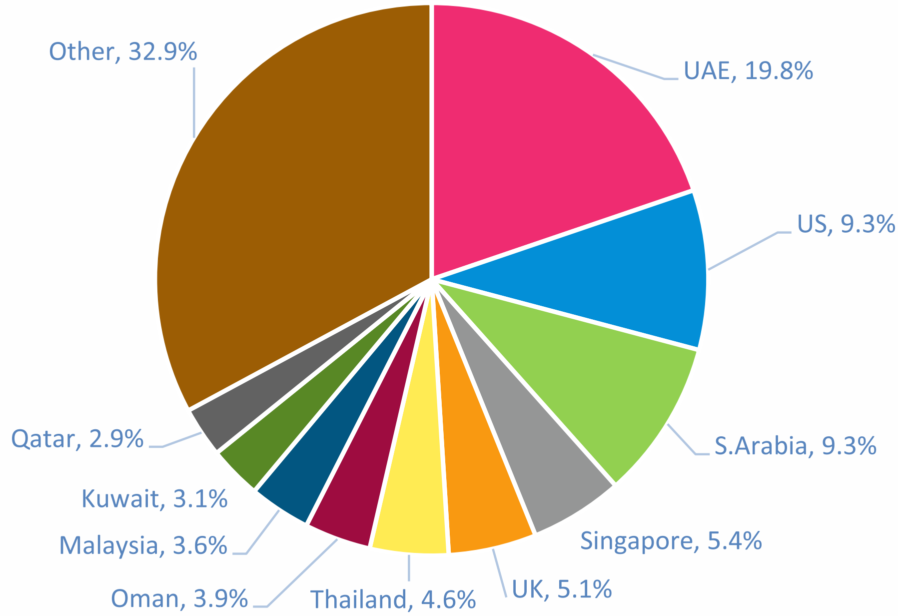


Source: IATA

Looking more closely at the composition of international travel, at the country-level, the top 10 international markets account for two-thirds of the total (Figure 22).

The United Arab Emirates (UAE) leads the way, with almost 20% of the total, followed by Saudi Arabia and the United States each with just over 9% market share.

Figure 22: Share of international traffic by country, 2017



Source: IATA

India's air cargo market

While the focus of this paper to date has been on the air passenger market, it would be remiss to overlook the air cargo segment.

This is particularly the case given India's integration into the global pharmaceutical value chains – a strong growth performer for the air cargo segment over recent years.

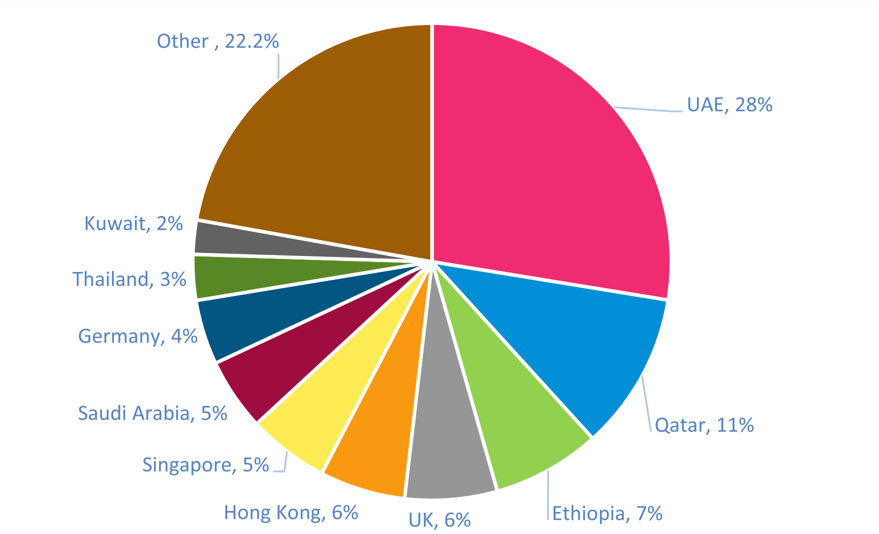
Nonetheless, 2017 was also an impressive year of growth for the Indian air cargo market.

The total cargo tonnage flown from India crossed the one million tonne threshold in 2017, with a strong, double-digit growth rate of 16.9%[5].

The top ten trading partner countries for Indian air cargo account for almost 78% of the total (Figure 23).

The UAE leads the way with almost a 30% market share, followed by Qatar with 11%.

Figure 23: Top freight country pairs from India, 2017



Source: IATA

Figure 24 depicts the relative market size (in tonnes) and the annual growth rate of India's top 10 air cargo trading partners.

While the UAE is clearly the largest market by some margin, the fastest growing market was Ethiopia, which more than doubled its cargo tonnage with India in 2017. Kuwait and Thailand also deserve a mention with growth exceeding 30% for the year for both countries.

Of the top ten markets, Hong Kong was the only one to see a fall in its cargo tonnage with India in 2017, down a modest 0.3% compared with its 2016 volume.

[5] The top freight country pairs cover all scheduled traffic, excl. integrators. The data are uni-directional in nature.

Figure 24: Top freight country pairs from India, tonnes & annual growth, 2017

	tonnes	%ch
UAE	292,556	4.7%
Qatar	113,652	18.2%
Ethiopia	77,626	114.4%
UK	66,275	16.0%
Hong Kong	61,460	-0.3%
Singapore	58,146	5.4%
Saudi Arabia	52,041	25.6%
Germany	46,583	6.3%
Thailand	32,872	34.2%
Kuwait	24,576	30.2%

Source: IATA WATS

As was the case on the passenger side, India has two airports ranked in the global top 10 fastest growing in 2017, namely Mumbai and Chennai.

These two airports recorded very strong growth of 18.1% and 17.2%, respectively in 2017 (Figure 25).

In terms of global rankings, Delhi and Mumbai appear in the list of the top 50 airports for freight handled, at #29 and #31, respectively.

Figure 25: The top 10 growth airports 2017 – cargo handled

Source: ACI, IATA WATS

Business models & industry structures continue to evolve

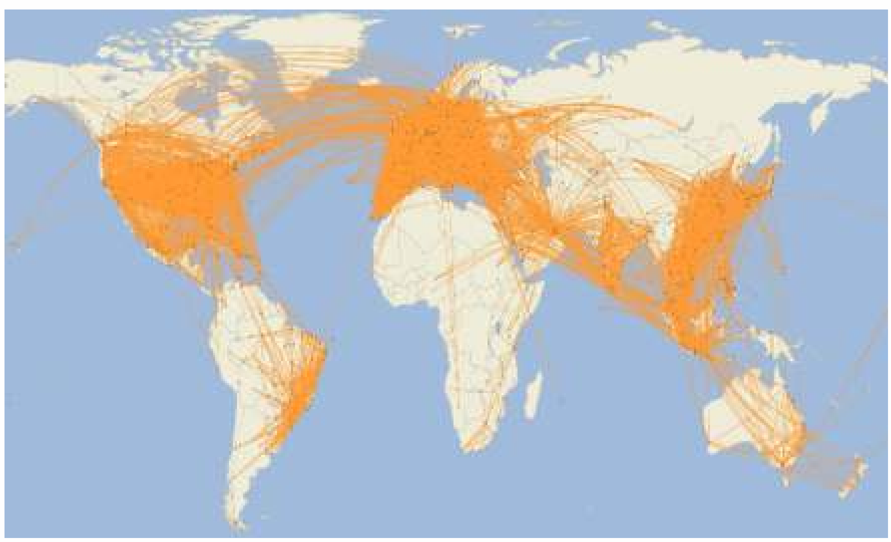
Globally, air transport is a highly dynamic industry and in this regard, the industry in India is no different.

As markets evolve and customer demands change, airlines must constantly review and update their operations and product offering to ensure that they continue to meet the market need.

One important part of this story is the evolution in business models and market structures observed in the industry, notably the rise of the so-called Low Cost Carrier (LCC) business model (Figure 26).

All told, at the global level, LCCs account for around 28% of the total number of seats flown.

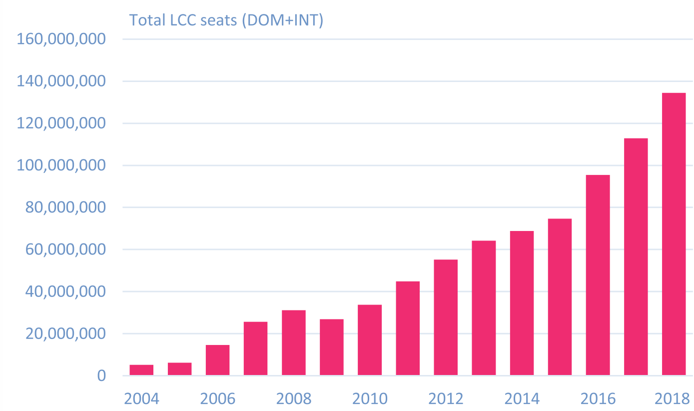
Figure 26: Proliferation of the LCC model globally



Source: SRS Analyser

For India the growth of the LCC market has been significant. In 2004 there were just over 5 million total LCC seats offered. Incorporating the schedules data for the remaining months of 2018, this figure has risen to almost 135 million seats – an increase of 27x in the 14-year period (Figure 27).

Figure 27: Increase in the number of LCC seats in the Indian air transport market



Source: SRS Analyser

Even if you consider just the past five year period, the number of LCC seats in the Indian market has more than doubled, from 64 million in 2013.

One of the key competitors for airlines domestically is the extensive train network in India. The train system carries more than 8 billion passengers per year. Many of these will be commuter trips over relatively short distances, for which air travel is not a viable substitute.

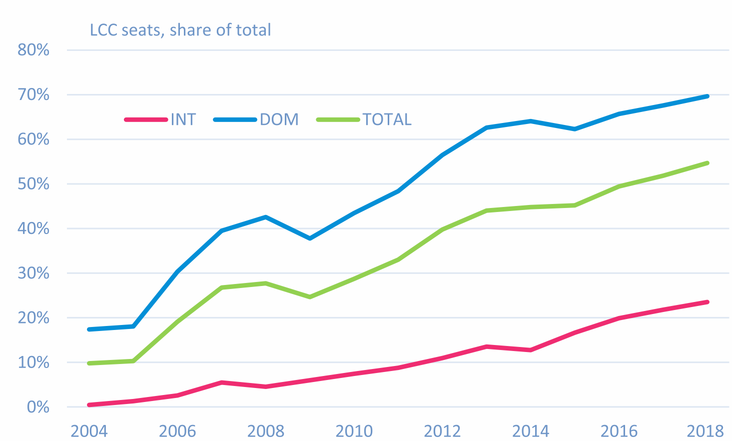
However, a proportion of these train journeys could potentially be taken by air; the market opportunity for an affordable airline alternative is clear.

Looking at the share of LCC seats in the Indian market brings to light a number of interesting observations.

Firstly, around 55% of all seats in the market are offered by low cost carriers (Figure 28). Focusing on the domestic market alone, the LCC share of total seats is almost 70%.

While the share of LCC seats offered on India's international routes is much smaller, at just under 25%, this share has risen from essentially zero in 2004.

Figure 28: Share of LCC seats in the Indian air transport market



Source: SRS Analyser

Arguably, the emergence of LCCs has facilitated the democratization of air travel and fueled aviation growth, albeit in various ways across different markets.

In emerging markets LLCs have broadened the market and allowed more people the opportunity to fly for the very first time. In more mature markets, LCCs have deepened the market allowing people to fly more often.

Given its prevalence, the LCC model cannot be ignored in any assessment of India's air transport market. However, LCCs aren't the only way in which the industry is evolving.

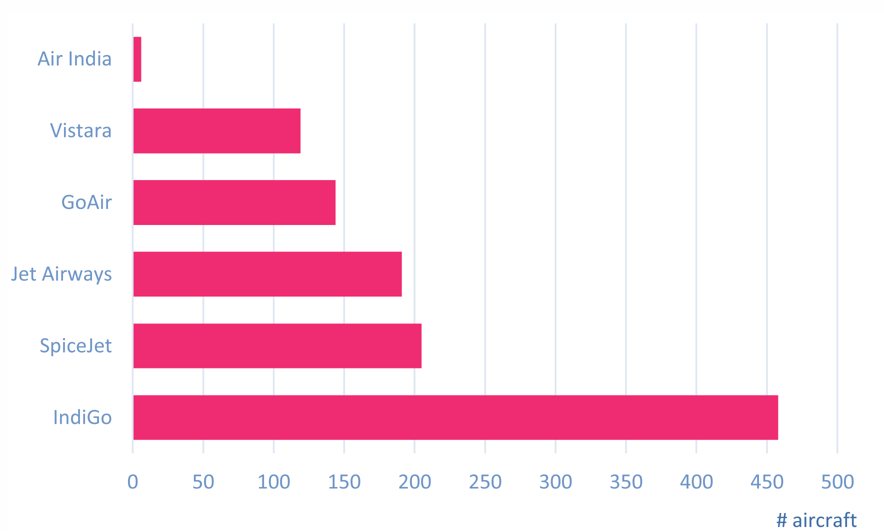
Increasingly, we are seeing a blurring of the traditional distinction between full service airlines and LCCs as each are increasingly adopting practices typically the domain of the other, resulting in a so-called 'hybrid' business model.

More broadly, there are range of new and alternative investment and alliance or partnership structures emerging globally which add a new dimension to the industry, as airlines try to find new and innovative ways to expand their networks and their product offering. In some global markets, the changing industry structure is one of consolidation rather than expansion.

These developments can apply to both the international and domestic markets. Indeed, some of these new structures and arrangements are evident in the Indian air transport industry, having been supported by changes in the regulatory and policy environment.

Amongst Indian airlines, there are currently around 600 aircraft in service. Evidencing the optimism and positive outlook for the sector, and providing some insights as to the near-term evolution of the market, some 1123 aircraft are currently on order for India. The bulk of these deliveries are currently slated for delivery to IndiGo – a major low cost carrier (Figure 29).

Figure 29: Aircraft currently on order – Indian airlines



Source: CAPA

Financial performance

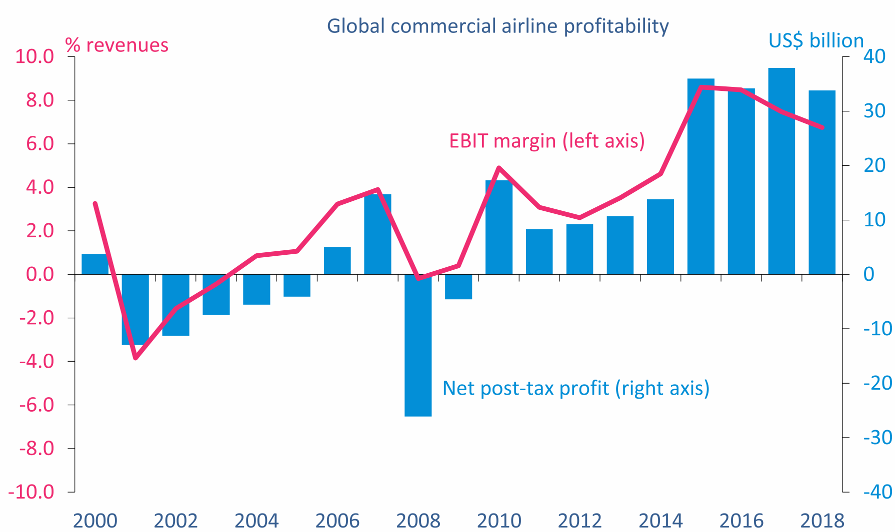
Historically, the global air transport industry has struggled to generate consistent profits. Even in periods of strong demand, profitability has, historically, proven to be elusive.

While, as a rule, airlines have been able to pay their debts, equity investors typically have not been adequately compensated for risking their capital in the sector.

The last three years – and we expect 2018 to be the fourth – have seen a turnaround in this situation at the global, industry-wide level.

The industry is now generating returns which exceed its cost of capital, and delivering a net profit figure of around US$30 billion per year (Figure 30).

Figure 30: Global airline industry financial performance

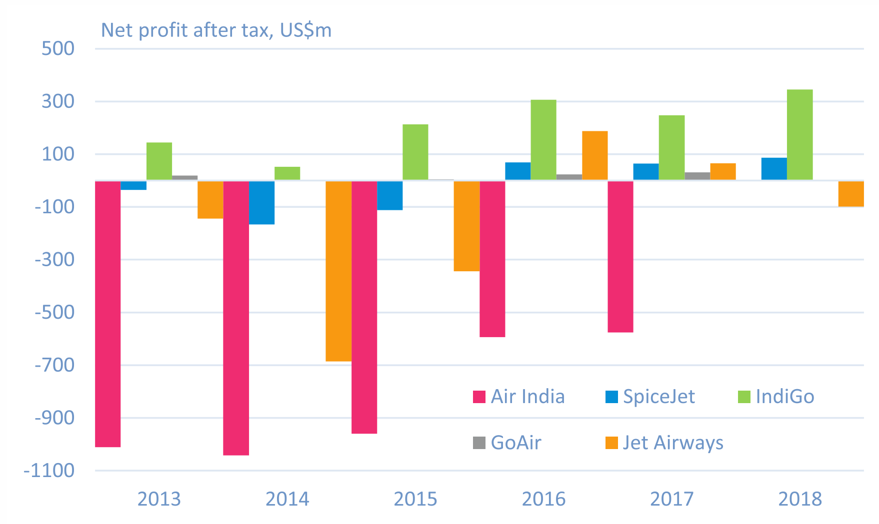


Source: IATA

Unfortunately, for the most part, the airlines in India have not yet been able to match this recent improvement in the industry-wide financial performance (Figure 31).

Over the period shown, most airlines have struggled to consistently generate a net profit after tax; the main exception being IndiGo who, along with GoAir, are the only airlines to have generated profits in each year of the period shown. The recent financial performance of Air India has been well-documented elsewhere.

*Figure 31: Financial performance of selected Indian airlines, Net profit after tax 2013-2018**

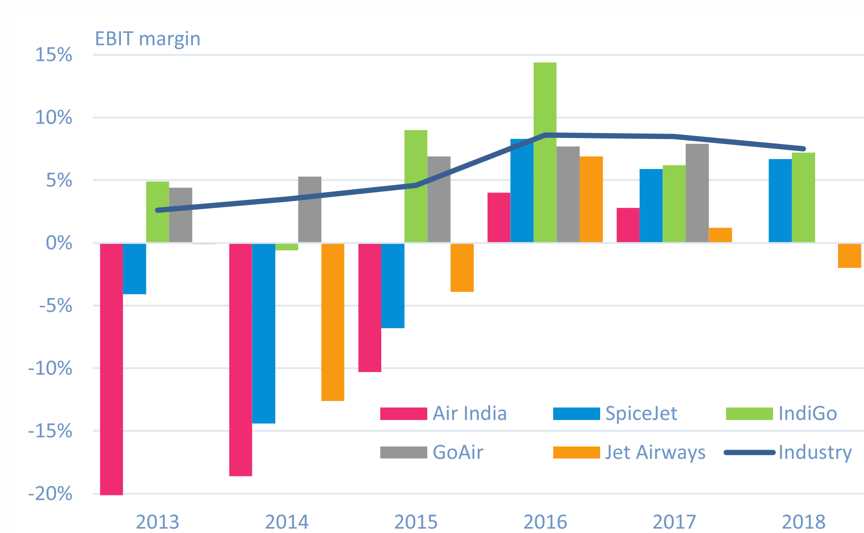


*Source: Airline Analyst * data relate to year-ended 31 March*

In a similar way, many Indian airlines have been unable to match the global industry performance in terms of operating (EBIT) margin either.

The performance of GoAir and IndiGo are again notable over the period, as is the improved financial results of SpiceJet in more recent years.

*Figure 32: FInancial performance of selected Indian airlines vs the global industry, EBIT margin 2013-2018**



*Source: Airline Analyst *data for Indian airlines related to year-ended 31 March, industry data relate to the calendar year prior*

It is clear that the overall industry in India is not yet on a sound financial footing and this remains a work-in-progress for the industry and its key stakeholders, including policy-makers.

While the industry has demonstrated resilience in the face of various shocks and disruption (including the global financial crisis and airline exits), financial stability is a key factor for the industry to be able to successfully develop and grow.

The value of air transport to India

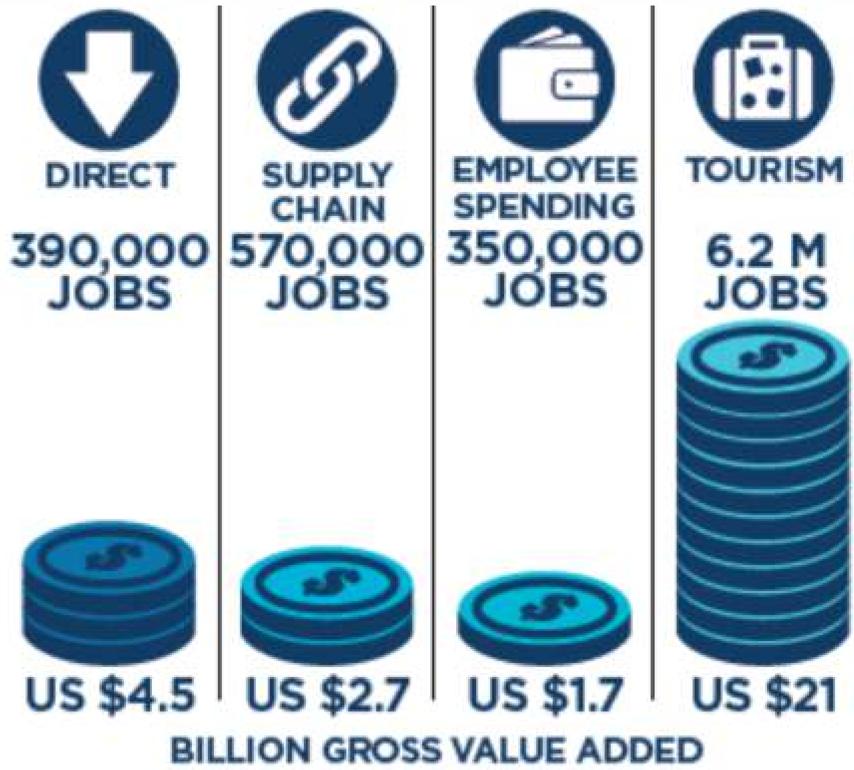
7.5m jobs and a $30bn contribution to GDP

The air transport sector makes a significant contribution to the Indian economy (Figure 33).

Analysis undertaken by Oxford Economics shows that the air transport sector directly contributes 390,000 jobs in India. This includes airlines, airport operators, airport on-site enterprises such as restaurants and retail, aircraft manufacturers and air navigation service providers.

In addition, by buying goods and services from local suppliers the sector supported another 570,000 jobs across the supply chain.

Figure 33: The value of aviation in India



Source: Oxford Economics, IATA

On top of this, the sector is estimated to have supported a further 350,000 jobs by paying wages to its employees, some or all of which are subsequently spent on consumer goods and services and create employment in other sectors of the economy.

Air transport brings tourists and investment into India, and helps businesses trade their goods and services around the world. Foreign tourists arriving by air to India, who spend their money in the local economy, are estimated to have supported an additional 6.2 million jobs.

But it's not all just about employment.

The air transport industry (directly and indirectly) is estimated to have supported an $8.9 billion gross value added contribution to GDP in India while spending by foreign tourists supported a further $21.2 billion gross value added contribution to GDP.

Furthermore, the air transport jobs tend to be highly productive – not just for their airline employers but for the economies in which they are employed.

The average air transport services employee in India generates nearly INR1.3 million in Gross Value Added annually, which is around 10 times more than the economy-wide average.

Looking forward

Sound fundamentals point to a bright future

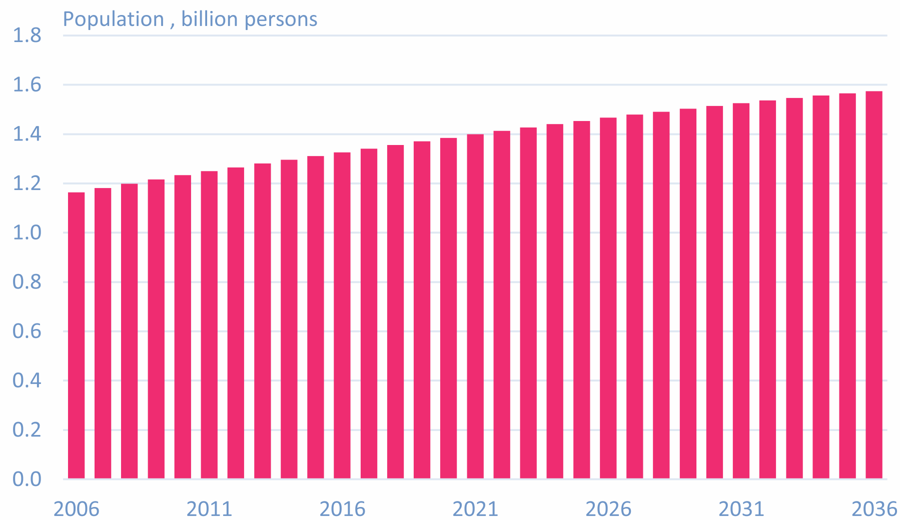
IATA's long-term passenger forecasts for India highlight the potential for significant growth in air transport demand over the next twenty years.

A favorable population and demographic profile – notably a relatively young population – along with the expected continuation of economic development and growth in household incomes underpins this very positive long-term outlook.

India's population is expected to increase further over the forecast horizon, rising from 1.3 billion persons currently to 1.6 billion by the end of our forecast horizon (Figure 34).

This ongoing population increase is expected to see India overtake China as the world's most populous country within the next decade. Of itself, a growing population will typically have a positive impact on the demand for air transport services.

Figure 34: India's population forecast

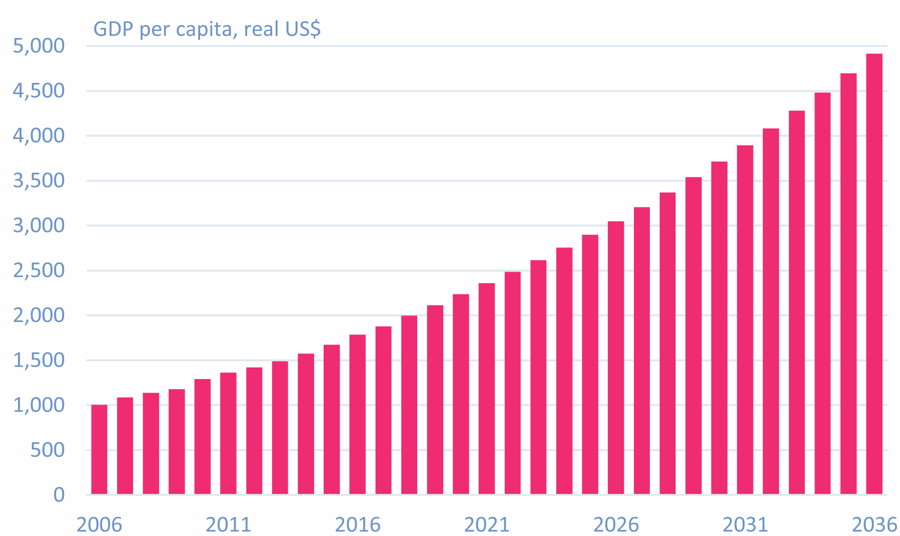


Source: Oxford Economics, IATA

In addition to the expected increase in population, India is also forecast to become a richer country over the next 20 years.

After adjusting for inflation, per capita incomes are expected to increase to almost US$5,000 per year in 2036, up five-fold since 2006 and more than double the current level (Figure 35).

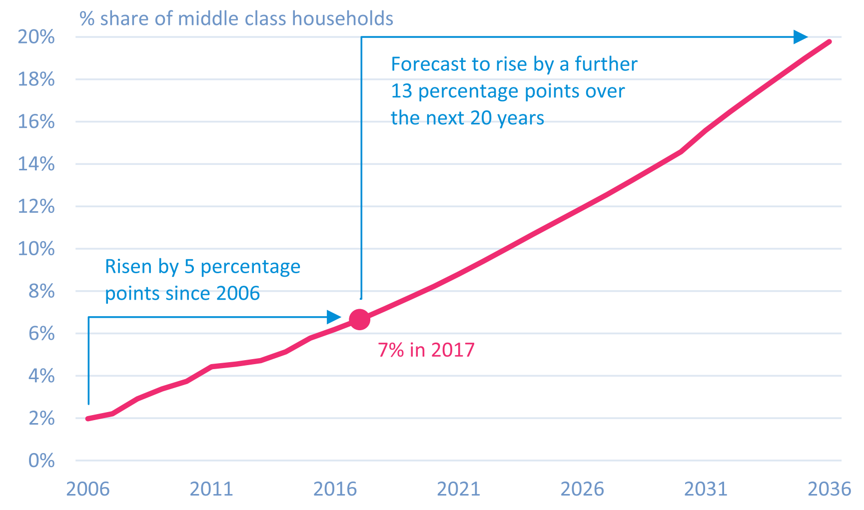
Figure 35: India's rising incomes – GDP per capita



Source: Oxford Economics

At the same time, the number of middle-class households in India is expected to continue to increase over the coming decades, to around 20% by 2036, compared with just 2% in 2006 (Figure 36).

Figure 36: Increase in the share of middle class households in India



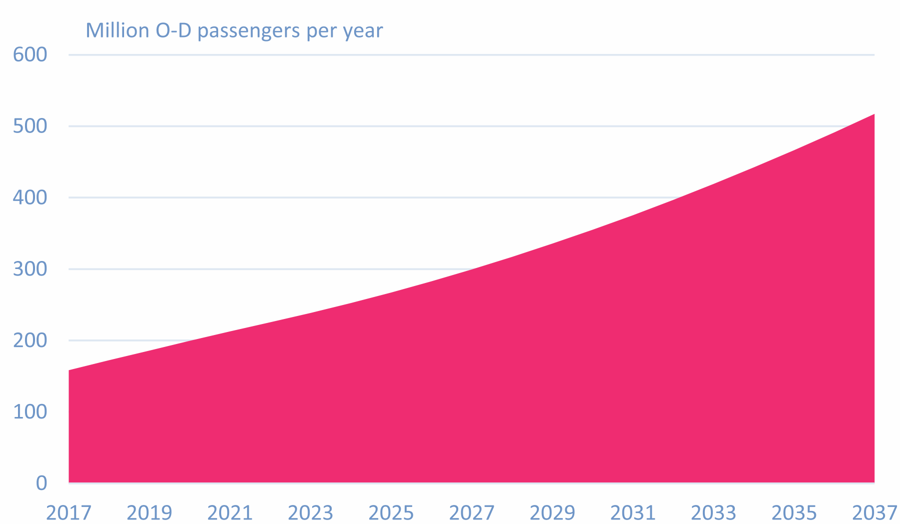
Source: Oxford Economics

The latest IATA/Tourism Economics (TE) forecasts suggest the demand for air travel to, from and within India – on an Origin-Destination basis – will increase at an average rate of 6.1% per year over the next twenty years.

India is forecast to gain an additional 359 million passengers by 2037, compared to 2017 (Figure 37); an increase of 3.3x the current level.

This means that, by 2037, there will be almost 520 million passengers flying to/from and within India each year.

Figure 37: India's forecast air passenger demand, 2017-37



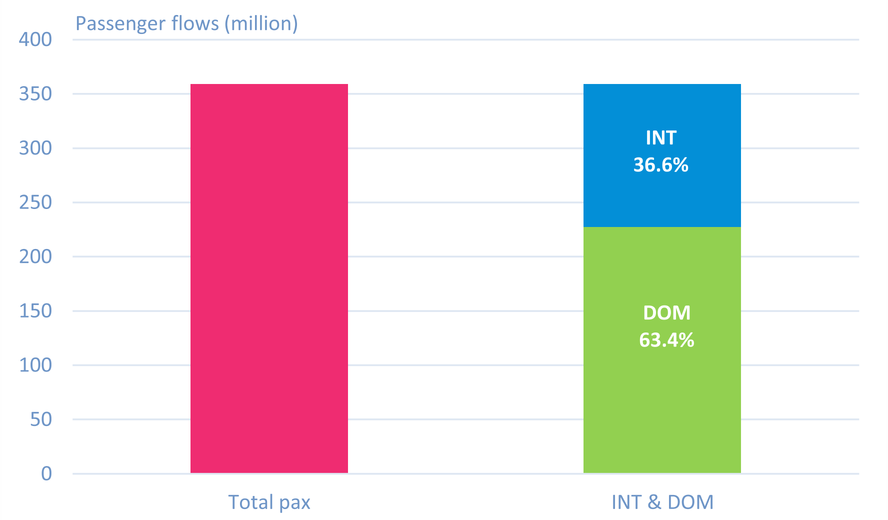
Source: IATA/TE

The additional 359 million passengers will not be sourced evenly from the domestic and international segments.

Domestic passengers will account for around 63% of the total growth over this period, or 228 million additional passengers.

Foreign passengers will contribute less to overall growth, representing 37% of the total market growth, equal to 131 million additional passengers (Figure 38).

Figure 38: Expected increase in Indian air passenger demand 2017-37, and DOM vs INT contributions



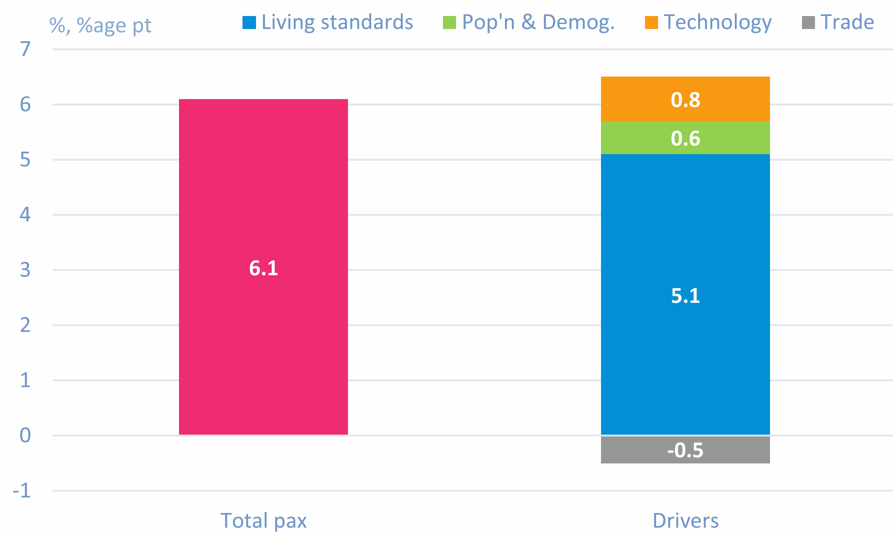
Source: IATA/TE

Of the 6.1% average annual growth in Indian air passenger demand over the next 20 years, improvements in living standards (via higher incomes) are expected to contribute the major share, at 5.1 percentage points.

Favourable population and demographic factors are forecast to contribute 0.6 percentage points to annual growth. Other factors, mainly future technological gains, will contribute 0.8 percentage points per year.

The modest subtraction from growth (0.5 percentage points) from trade mainly reflects the Oxford Economics view that the economy will become slightly less trade intensive over the forecast horizon (Figure 39).

Figure 39: Sources of growth in India's air passenger demand, 2017-37

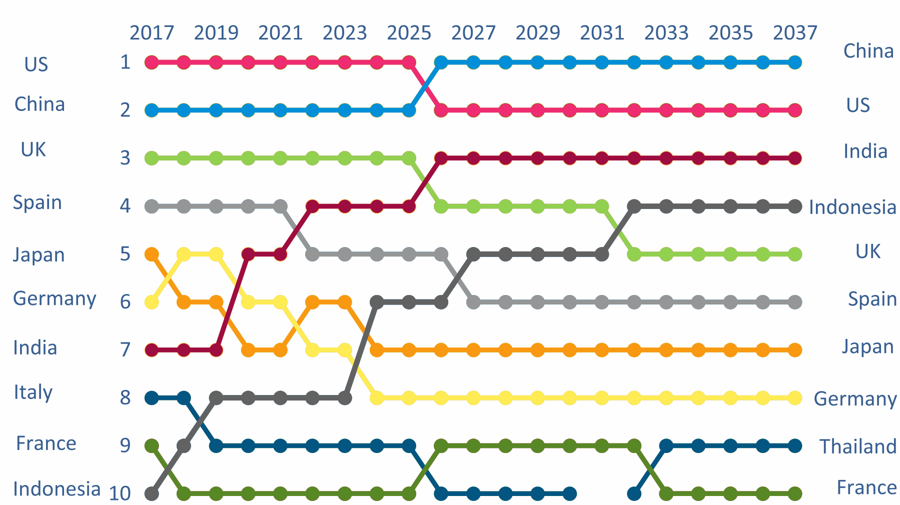


Source: IATA/TE

Putting this performance into a global context, the positive outlook will see India move up from the #7 ranked largest air passenger market in the world currently to #3 (behind China and the United States) within the next decade. India will hold this position through to the end of our forecast horizon in 2037.

Along the way, India will overtake Germany, Japan, Spain and the United Kingdom (Figure 40).

Figure 40: Top 10 global air transport markets, 2017-37



Source: IATA/TE

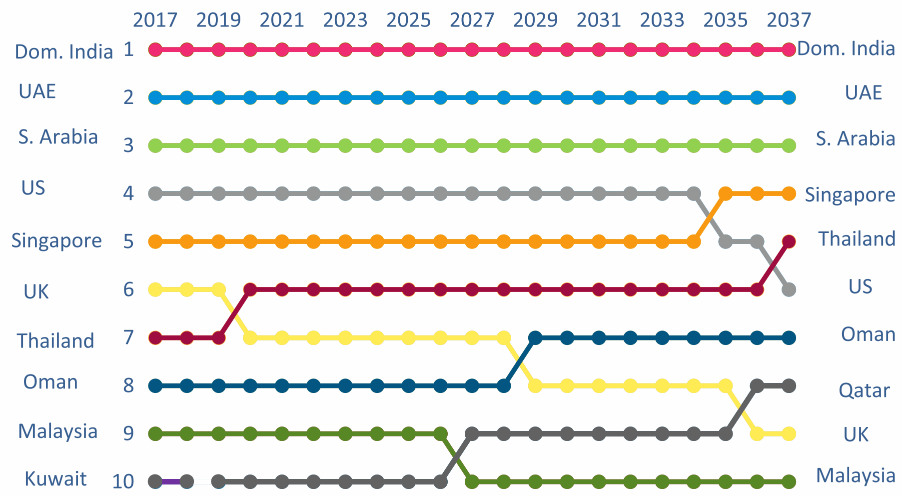
The composition of the top ten air transport markets for India show relatively little change over the 20-year forecasting horizon.

Kuwait is set to drop out of the top 10, to be replaced by Qatar as the only compositional change expected. The top 3 markets (Domestic India, the UAE and Saudi Arabia) are all expected

to maintain their ranking over the forecast period (Figure 41).

The mature air transport markets of the UK and US are expected to see the largest decline in rankings, losing 3 places and 2 places to #9 and #6, respectively.

Figure 41: Top 10 Indian air transport markets, 2017-37



Source: IATA/TE

The policy environment matters

It is important to note that while the fundamental drivers of air passenger demand provide a favorable tailwind to growth in the sector, these outcomes are not guaranteed.

Demand forecasts can be impacted – either positively or negatively – by a range of other factors, including the availability of infrastructure and broader government policy decisions around market regulation and liberalization, for example.

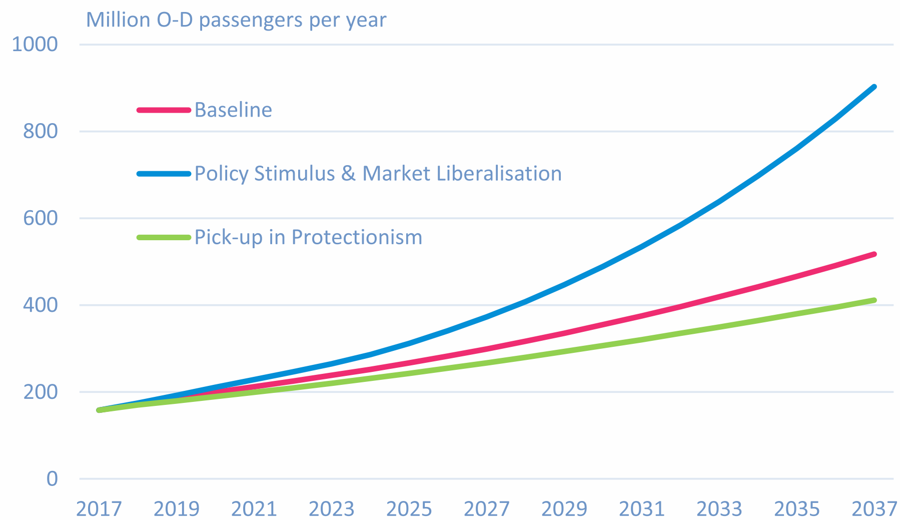
Air passenger forecast scenarios

As part of the forecast process, we prepare two generic global scenarios.

The scenarios are designed to demonstrate the possible impacts on air passenger demand of both a more favorable future outcome (where there is policy stimulus and further air transport market liberalization) and a less favorable future outcome where policies are more restrictive and there is a pick-up in protectionism.

The effect of these two broad scenarios on India's air passenger demand forecasts are depicted in Figure 42.

Figure 42: India's air passenger demand outlook under three scenarios, 2017-37



Source: IATA/TE

Under the less favorable scenario, India's air passenger market will still grow, albeit at a slower pace, of 4.9% per year. While this difference doesn't seem significant, it translates to more than 100 million less passengers per year in 2037 than under the 'constant policies' scenario.

On the upside, a more favorable policy backdrop could see air passenger demand for India growing at a near-double digit annual pace of 9.1%, generating an additional 385 million passengers in 2037 compared with the constant policies scenario. This would take the number of passengers travelling to, from and within India by air to just over 900 million in 2037.

National Civil Aviation Policy

In the Indian context, no consideration of the policy environment could overlook the recent National Civil Aviation Policy (NCAP).

The 2016 introduction of the NCAP brought a number of important initiatives and developments to India's air transport industry.

The policy addresses a range of key areas for civil aviation including airline operations, safety and security, international traffic rights and maintenance, repair and overhaul (MRO) operations.

The NCAP aims to make flying more affordable and convenient to the general population, including by establishing a regional air connectivity scheme, the UDAN initiative.

More recently, a new draft scheme has been announced seeking to extend the UDAN framework to international routes.

Travel & Tourism Competitiveness

The World Economic Forum's (WEF) Travel and Tourism Competitiveness Index provides a framework to assess and benchmark the factors and policies which impact a country's T&T sector competitiveness.

In its latest report, India ranks #40 out of the 136 countries assessed, a strong improvement of 12 places over the previous survey (Figure 43).

India's strengths include its vast cultural and natural resources (ranked 9th and 24th, respectively), and its price competitiveness advantage (10th).

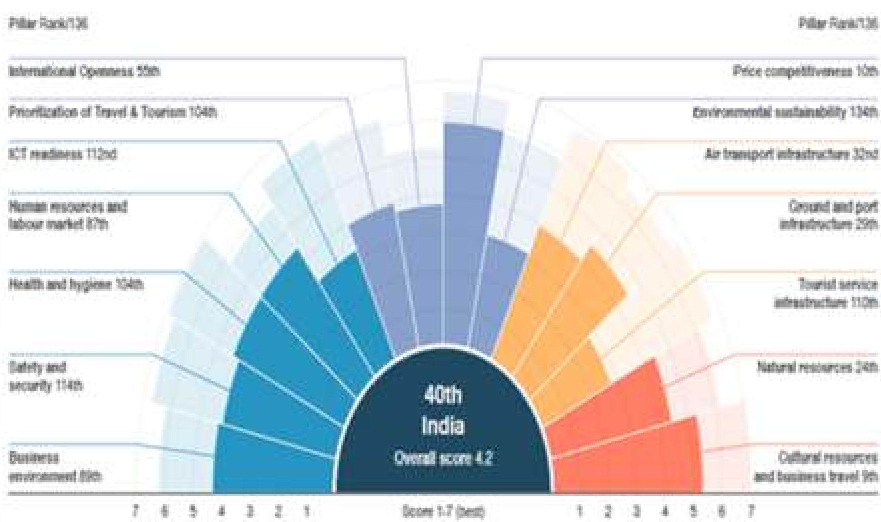
The WEF notes that India continues to enrich its cultural resources, protecting more cultural sites and intangible expressions through UNESCO World Heritage lists, and via a greater digital presence.

International openness (55th, up 14 places), through stronger visa policies implementing both visas on arrival and e-visas, has enabled India to rise up through the global ranking.

The travel and tourism sector benefited from improvements in India's transport infrastructure, which the WEF notes has traditionally been a challenging area.

In this regard, it is notable, that the air transport infrastructure sub-component places India 32nd currently in the global ranking.

Figure 43: India's travel & tourism competitiveness



Source: WEF

Nonetheless, there is always room for improvement which could lift India's ranking into the top quartile of countries.

Within the air transport infrastructure category, India ranks relatively low (133rd) in terms of airport density (the number of airports per million of population) and 108th for the number of departures per 1000 population.

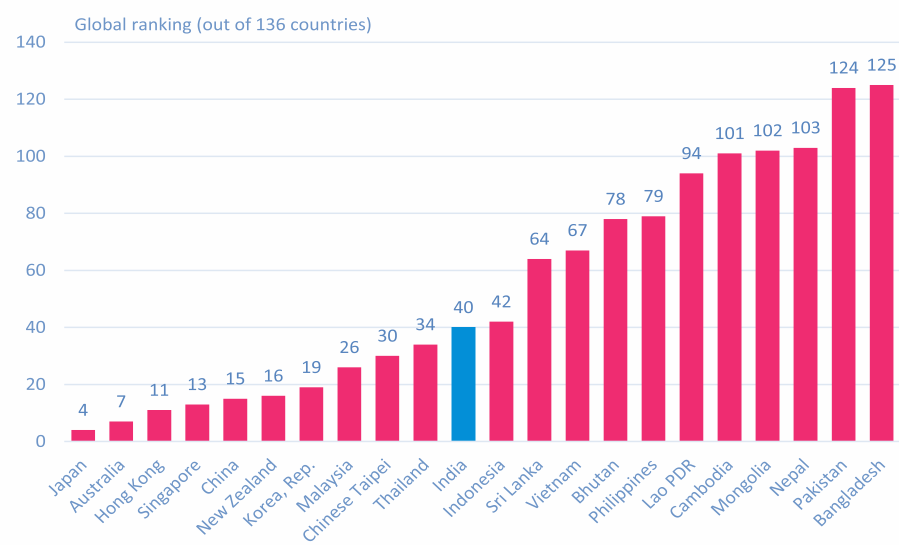
While health conditions in the country continue to improve, the WEF includes India towards the lower end of its global rankings for this indicator (104th).

Similarly, the WEF notes that while India's ICT readiness (112th), security concerns (114th), tourist service infrastructure (110th) and human resources (87th) are slowly improving, further work is required across these dimensions to lift India's overall global ranking.

Importantly, the WEF are clear that steps are already being taken in the right direction to address the shortcomings and conclude that "the Indian transport and tourism sector presents significant opportunities that are yet to be reaped".

India's travel and tourism competitiveness ranking relative to its Asia Pacific peers is shown in Figure 44.

Figure 44: Asia Pacific travel & tourism competitiveness rankings



Source: WEF

Ease of Doing Business

The robustness and efficiency of the broader business environment is also important – not just for air transport sector and related parts of the industry supply chain.

A strong and vibrant business environment stimulates employment opportunities, investment and trade which the air transport sector can both help to enhance and benefit from.

The World Bank's Ease of Doing Business Index is designed to provide objective data for use by governments in designing sound business regulatory policies.

The latest index ranks India mid-range, at #100 of 190 countries, slightly ahead of the South Asia regional average (Figure 45).

Figure 45: World Bank Ease of Doing Business ranking 2018 (distance to frontier)[6]

Source: World Bank

Key challenges for India highlighted by the World Bank include dealing with construction permits (ranked #181), enforcing contracts (#164) and trading across borders (#146).

Importantly, and as was the case with the WEF measure discussed above, improvements in the broader business environment in India are underway; India's ease of doing business ranking has risen from #132 just five years ago, clearly moving in the right direction.

[6]The distance to frontier measure shows the gap to the best performance observed on each of the indicators. A scale from 0 to 100 is used, where 0 is the lowest performance and 100 is the frontier.

Concluding comments

Air transport is the business of freedom. It is so much more than just moving people and cargo from one destination to another.

Air transport helps to bring families together, it supports and enhances business and investment decisions, it promotes the transfer of knowledge and innovation, and provides opportunities to study abroad and experience different cultures.

As this paper has made clear, the future of India's air transport industry is bright.

However, this does not mean that that the future flightpath will be without turbulence.

The significant growth potential of the industry in India will also create challenges – for the airlines, its industry partners and policy-makers alike – to ensure that this growth potential can be met.

For example, this will require the right type of infrastructure to be put into place, at the right time and in the right place. Infrastructure is not just airports, it includes investment and supporting services, both on the ground and in the air.

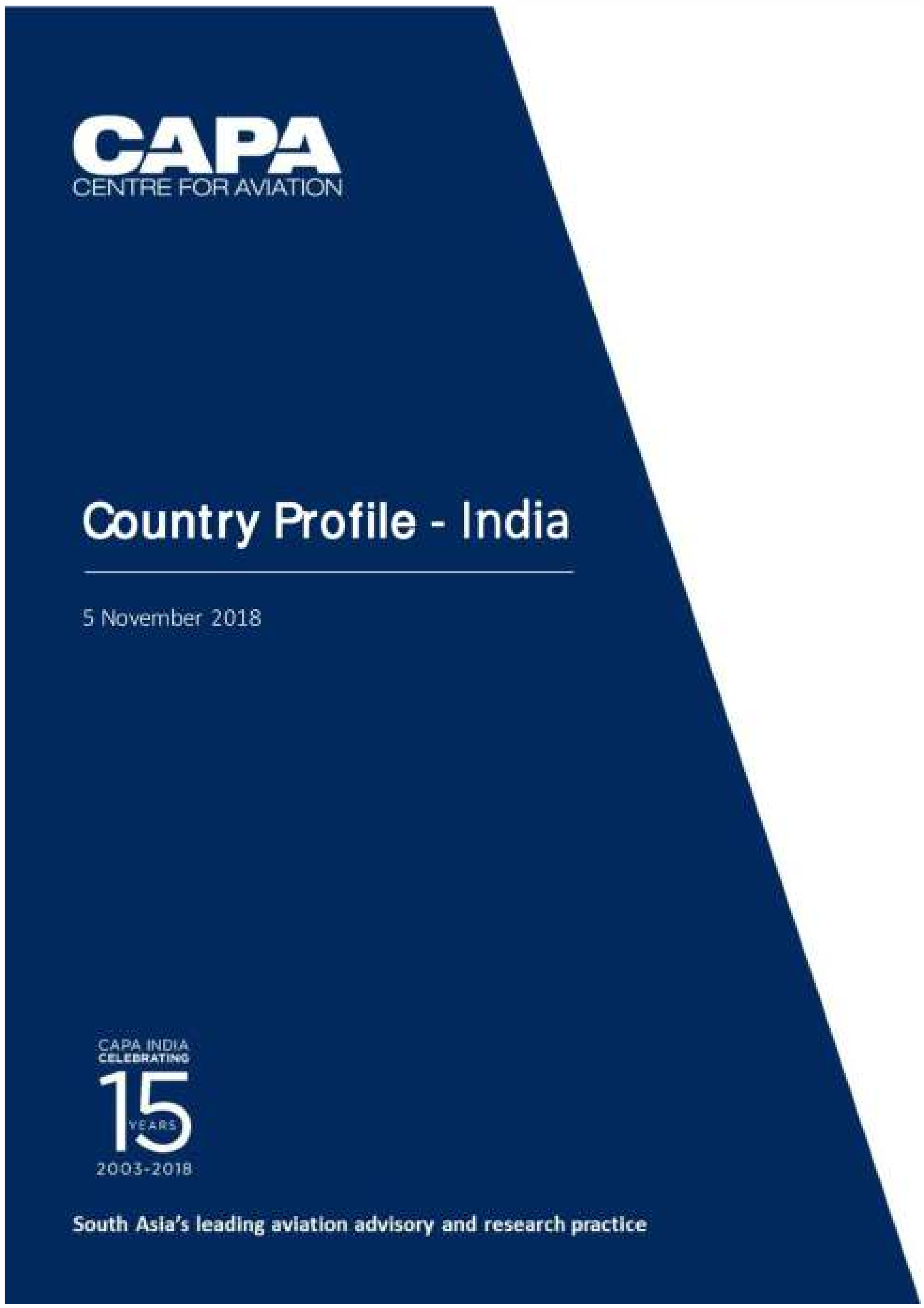
Equally, the broader business and policy environment should not place unnecessary hurdles before the industry which inhibit its growth and development and, in turn, reduce the level of benefits that aviation can deliver to the nation.

There is no doubt that this is an exciting period for air transport in India.

And there is a clear mandate for the industry, its supply chain partners and the government and policy-makers to all work in a collaborative manner, towards the common goal of ensuring that the benefits that the air transport industry can bring to India are fulfilled.

IATA Economics
economics@iata.org
August 2018

ANNEX VIII


CAPA
CENTRE FOR AVIATION

Country Profile - India

5 November 2018

CAPA INDIA
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15
YEARS
2003-2018

South Asia's leading aviation advisory and research practice

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Table of Contents

Overview

India

India's aviation sector has undergone rapid transformation since the liberalisation drive that began in 2003. The country has one state-owned airline, Air India (with a low cost international subsidiary, Air India Express), and six major airlines, which between them transported 145 million domestic and international passengers p/a. Total passenger numbers handled at Indian airports were approximately 309 million, making it one of the ten largest markets globally. Strong GDP growth, a young population and the expansion of India's vibrant middle class sees India achieve some of the fastest growth of any aviation market in the world. And if costs can be continually brought down and competition remains strong, low fares should further stimulate new demand and draw millions of passengers away from the extensive rail network to faster and more comfortable air services.

The Ministry of Civil Aviation of India is responsible for the formulation of national policies and programmes for development and regulation of Civil Aviation and for devising and implementing schemes for the orderly growth and expansion of civil air transport. Its functions also extend to overseeing airport facilities, air traffic services (via Airports Authority of India) and carriage of passengers and goods by air (via the Directorate General of Civil Aviation).

IATA	IN
Region	Asia : South Asia

Airlines within India

Air Deccan	Alliance Air	Airways	Air)
Air India	Blue Dart Aviation	IndiGo	Quikjet Airlines
Air India Cargo	Club One Air	Jagson Airlines	Sky Airways
Air India Express	Deccan Charters	Jet Airways	Skyjet Airways
Air India Regional	FLYeasy	JetLite	Sovika Aviation Services
Air Kerala	Flyington Freighters	JetSmart (India)	SpiceJet
Air Odisha	Global Vectra Helicorp	Kairali Airlines	SpiceXpress
Air SGS	GoAir	Mesco Airlines	Star Air (India)
AirAsia India	Himalayan Bulls Airlines	MSD Aviation	Summit Aviation Pvt Ltd
AirOne (India)	India International	Premier Airways (Easy	Trans Bharat Aviation

CAPA INDIA

- TruJet
- UTair India
- Ventura Airconnect
- Vistara
- VRL
- Yuva JetLines Airways
- Zav Airways
- Zexus Air
- Zoom Air (India)

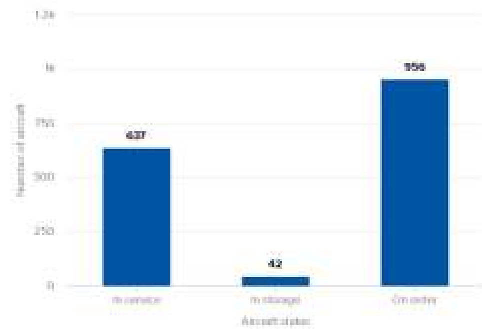
Airports within India

- (old) Hyderabad Begumpet Airport
- Adampur Airport
- Agartala Singerbhil Airport
- Agatti Island Airport
- Agra Kheria Airport
- Ahmedabad Airport
- Aizawl Lengpui Airport
- Ajmer Kishangarh Airport
- Akola Airport
- Aligarh Airport
- Allahabad Bamrauli Airport
- Along Airport
- Ambala Airport
- Ambikapur Darima Airport
- Amravati/Belora Airport
- Amritsar Sri Guru Ram Dass Jee Airport
- Aurangabad Chikkalthana Airport
- Bagdogra Airport
- Ballari Airport
- Balurghat Airport
- Bangalore Kempegowda International Airport
- Baramati Airport
- Bathinda Airport
- Belgaum Airport
- Bhavnagar Airport
- Bhopal Raja Bhoj Airport
- Bhubaneswar Biju Patnaik Airport
- Bhuj Rudra Mata Airport
- Bidar Airport
- Bikaner Airport
- Bilaspur Airport
- Brahmapur Airport
- Chandigarh Airport
- Chandrapur Airport
- Chennai International Airport
- Coimbatore Peelamedu Airport
- Cooch Behar Airport
- Daporijo Airport
- Darbhanga Airport
- Dehradun Airport
- Delhi Indira Gandhi International Airport
- Delhi Safdarjung Airport
- Dharamsala Gaggal Airport
- Dibrugarh Chabua Airport
- Dimapur Airport
- Diu Airport
- Donakonda Airport
- Dumka Sido Kanhu Airport
- Durgapur Kazi Nazrul
- Islam Airport
- Faizabad Airport
- Farrukhabad Airport
- Gaya Airport
- Goa Dabolim International Airport
- Gondia Airport
- Gorakhpur Airport
- Gulbarga Airport
- Guwahati Lokpriya Gopinath Bordoloi Airport
- Gwalior Airport
- HAL Bangalore International Airport
- Hindon Airport
- Hisar Airport
- Hubballi Airport
- Hyderabad Rajiv Gandhi International Airport
- Imphal Municipal Airport
- Indore Devi Ahilyabai Holkar Airport
- Jabalpur Airport
- Jagdalpur Airport
- Jaipur Sanganeer Airport
- Jaisalmer Airport
- Jalgaon Airport
- Jammu Satwari Airport
- Jamnagar Govardhanpur Airport
- Jamshedpur Sonari Airport
- Jeypore Airport
- Jharsuguda Airport
- Jodhpur Airport
- Jorhat Rowriah Airport
- Kadapa Airport
- Kailashahar Airport
- Kamalpur Airport
- Kandla Airport
- Kanpur Airport
- Kargil Airport
- Keshod Airport
- Khajuraho Airport
- Kochi/Cochin International Airport
- Kolhapur Airport
- Kolkata Netaji Subhas Chandra Bose Airport
- Kota Airport
- Kozhikode Calicut Airport
- Kullu Bhuntar Airport
- Latur Airport
- Leh Airport
- Lilabari Airport
- Lucknow Amausi Airport
- Ludhiana (Sahnewal) Airport
- Madurai Airport
- Malda Airport

- Mangalore Bajpe Airport
- Meerut Bheem Rao Ambedkar Airport
- Moradabad Mundha Pande Airport
- Mumbai Chhatrapati Shivaji Maharaj International Airport
- Mumbai Juhu Airport
- Mundra Adani Airport
- Muzaffarnagar Airport
- Muzaffarpur Airport
- Mysore Airport (Mysuru Airport)
- Nagpur Sonegaon Airport
- Nanded Airport
- Nashik Ozar Airport
- Osmanabad Airport
- Pakyong Sikkim Airport
- Pantnagar Airport
- Pasighat Airport
- Pathankot Airport
- Patna Airport
- Pithoragarh Airport
- Porbandar Airport
- Port Blair Airport
- Puducherry Airport
- Pune Lohegaon Airport
- Puttaparthi Sri Sathya Sai Airport
- Raebareli Airport
- Raipur Swami Vivekananda Airport
- Rajahmundry Airport
- Rajkot Civil Airport
- Ranchi Birsa Munda Airport
- Raxaul Airport
- Rourkela Airport
- Rupsi Airport
- Saharanpur Airport
- Saifai Airport
- Salem Airport
- Shillong Airport
- Shimla Airport
- Shirdi Sri Saibaba International Airport
- Sholapur Airport
- Silchar Kumbhirgram Airport
- Sirsa Airport
- Srinagar Airport
- Surat Airport
- Tezpur Salonibari Airport
- Tezu Airport
- Thiruvananthapuram Trivandrum International
- Airport
- Tiruchirappalli Airport
- Tirupati Airport
- Tuticorin Airport
- Udaipur Dabok Airport
- Utkela Airport
- Vadodara Airport
- Varanasi Airport
- Vellore Airport
- Vidyanagar Jindal Airport
- Vijayawada/ Gannavaram Airport
- Visakhapatnam Airport
- Warangal Airport
- Yavatmal Airport
- Ziro Airport

Fleet

India fleet aircraft as at 05-Nov-2018

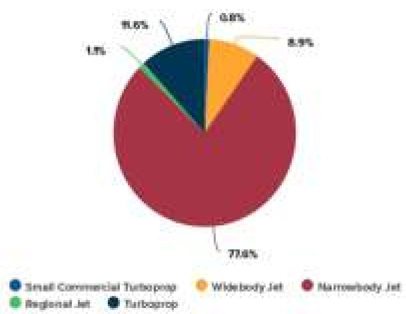


Source: CAPA Fleet Database

India projected delivery dates for aircraft on order as at 05-Nov-2018

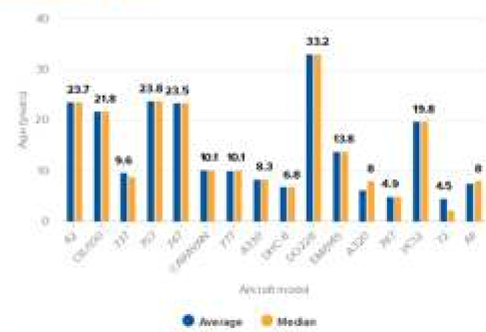
Source: CAPA Fleet Database

India fleet breakdown for aircraft in service as at 05-Nov-2018



Source: CAPA Fleet Database

India average fleet age for aircraft in service as at 05-Nov-2018

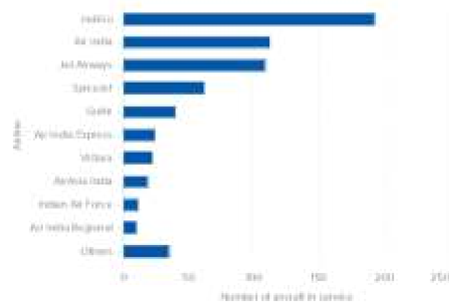


Source: CAPA Fleet Database

CAPA INDIA

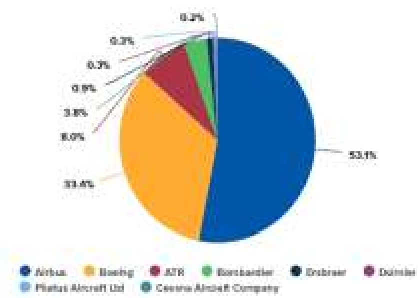
India: Fleet

India aircraft in service by airline as at 05-Nov-2018



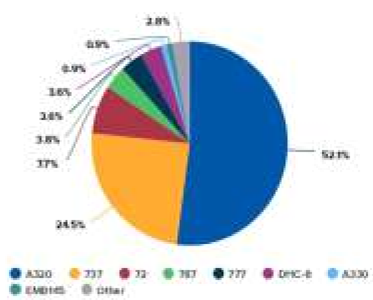
Source: CAPA Fleet Database

India aircraft by manufacturer in service as at 05-Nov-2018



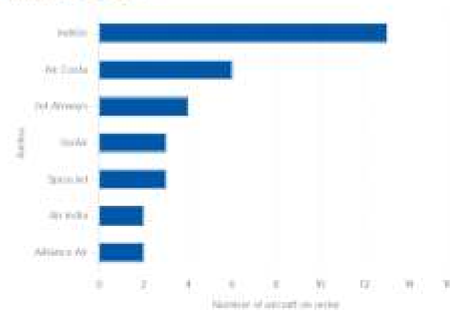
Source: CAPA Fleet Database

India aircraft share by aircraft in service as at 05-Nov-2018



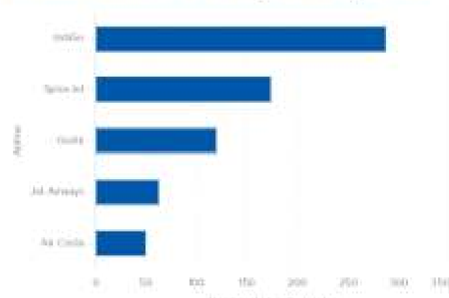
Source: CAPA Fleet Database

India deliveries by airline aircraft on order by airline for 2018



Source: CAPA Fleet Database

India airlines with more than 50 upcoming deliveries aircraft on order by airline by 2028

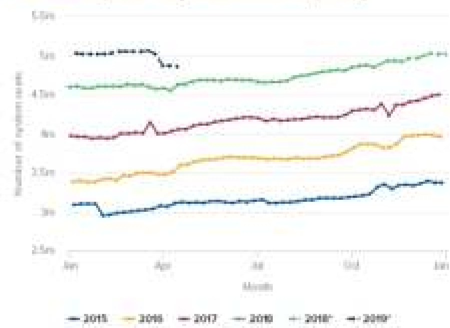


Source: CAPA Fleet Database

CAPA INDIA

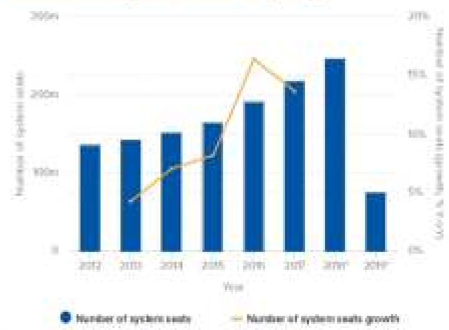
Schedules Analysis

India weekly total system seats capacity



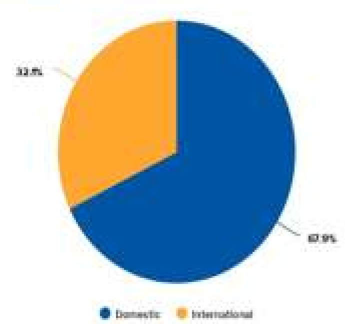
Source: CAPA - Centre for Aviation and OAG
* These values are at least partly predictive up to 6 months from 05-Nov-2018 and may be subject to change

India annual system seats capacity



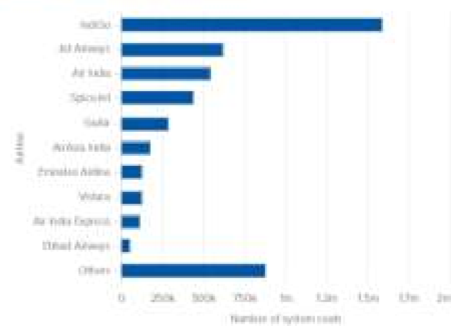
Source: CAPA - Centre for Aviation and OAG
* The values for this year are at least partly predictive up to 6 months from 05-Nov-2018 and may be subject to change.

India international vs domestic seats
Week commencing 05-Nov-2018



Source: CAPA - Centre for Aviation and OAG

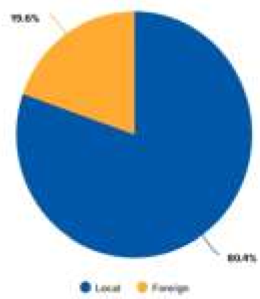
India system seats for all business models
Week commencing 05-Nov-2018



Source: CAPA - Centre for Aviation and OAG

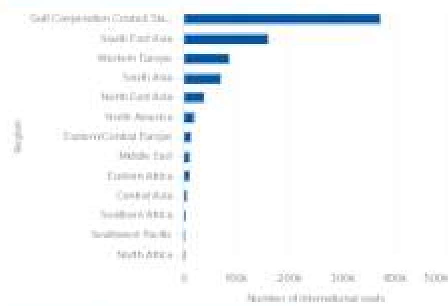
India: Schedules Analysis

India local vs foreign airline system seats
Week commencing 05-Nov-2018



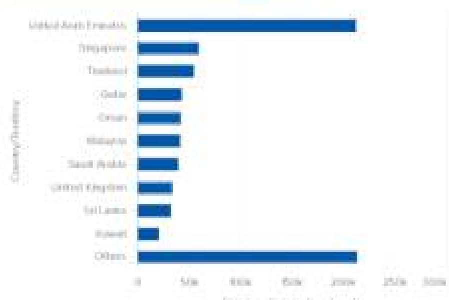
Source: CAPA - Centre for Aviation and OAG

India international departing seats by region
Week commencing 05-Nov-2018
Include home country/territory departures



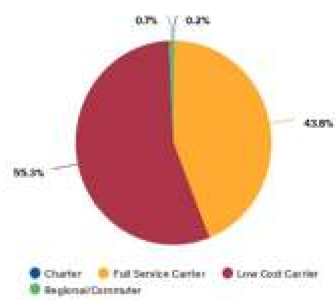
Source: CAPA - Centre for Aviation and OAG

India international departing seats by country/territory
Week commencing 05-Nov-2018
Include home country/territory departures



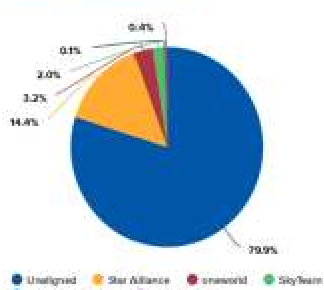
Source: CAPA - Centre for Aviation and OAG

India system seats by business model
Week commencing 05-Nov-2018



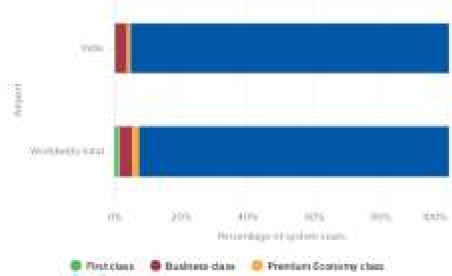
Source: CAPA - Centre for Aviation and OAG

India system seats by airline alliance
Week commencing 05-Nov-2018



Source: CAPA - Centre for Aviation and OAG

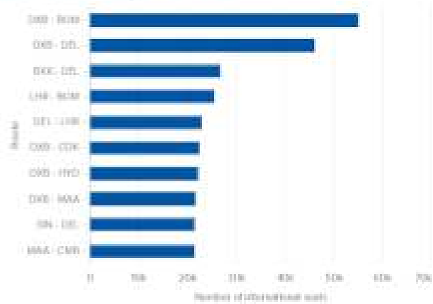
India system departing seats by class
Week commencing 05-Nov-2018



Source: CAPA - Centre for Aviation and OAG

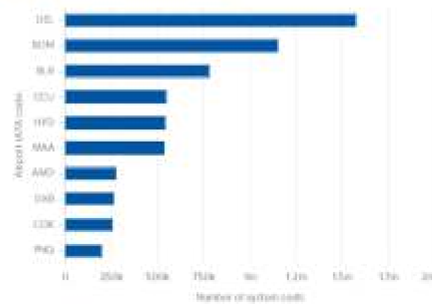
India: Schedules Analysis

India top ten international seats by route
Week commencing 05-Nov-2018



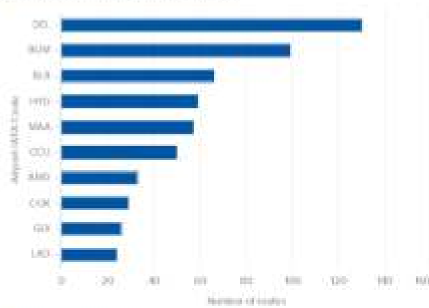
Source: CAPA - Centre for Aviation and OAG

India top ten hubs/bases/stations by system seats
Week commencing 05-Nov-2018



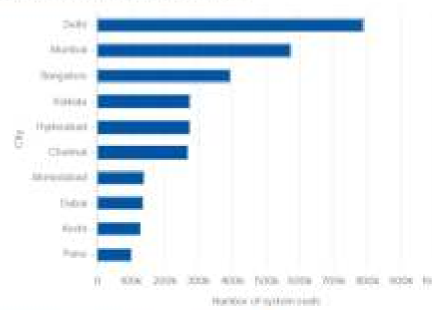
Source: CAPA - Centre for Aviation and OAG

India top ten routes by origin
Week commencing 05-Nov-2018



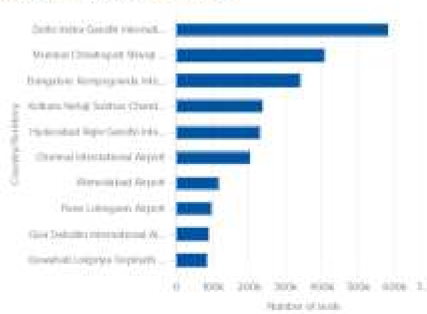
Source: CAPA - Centre for Aviation and OAG

India top ten system departing seats by city
Week commencing 05-Nov-2018



Source: CAPA - Centre for Aviation and OAG

Top ten airports for international arrivals into India seats
Week commencing 05-Nov-2018



Source: CAPA - Centre for Aviation and OAG

CAPA INDIA

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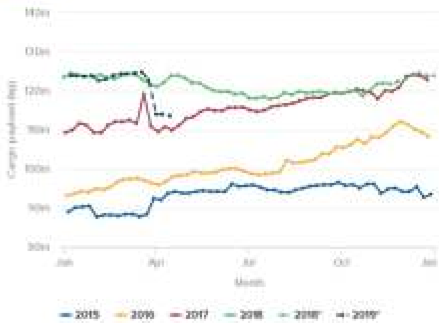
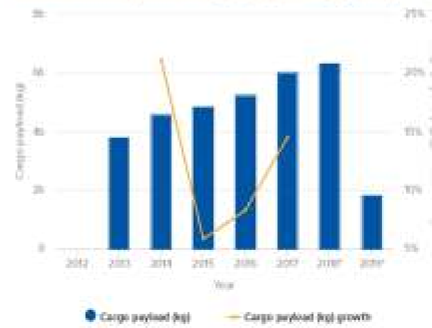
Cargo Analysis

India weekly total system cargo payload (kg) capacity



Source: CAPA - Centre for Aviation and OAG
* These values are at least partly predictive up to 6 months from 05-Nov-2018 and may be subject to change

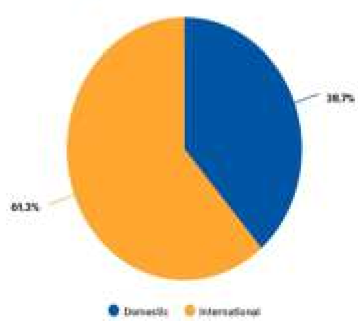
India annual system cargo payload (kg) capacity



Source: CAPA - Centre for Aviation and OAG
* The values for this year are at least partly predictive up to 6 months from 05-Nov-2018 and may be subject to change.

India international vs domestic cargo payload (kg)

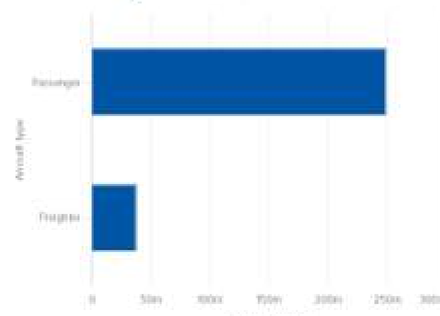
Week commencing 05-Nov-2018



Source: CAPA - Centre for Aviation and OAG

India system cargo payload (kg) passenger vs freighter split

Week commencing 05-Nov-2018



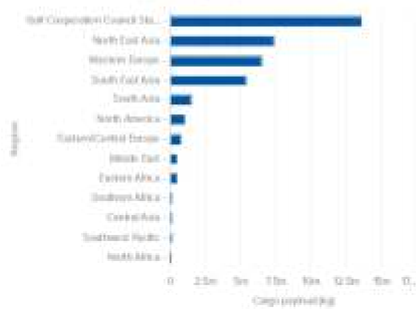
Source: CAPA - Centre for Aviation and OAG

CAPA INDIA

Page 9

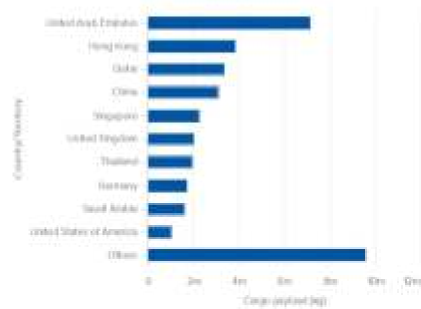
India: Cargo Analysis

India international departing cargo payload (kg) by region
Week commencing 05-Nov-2018
Include home country/territory departures



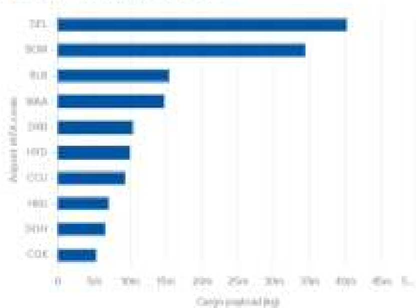
Source: CAPA - Centre for Aviation and OAG

India international departing cargo payload (kg) by country/territory
Week commencing 05-Nov-2018
Include home country/territory departures



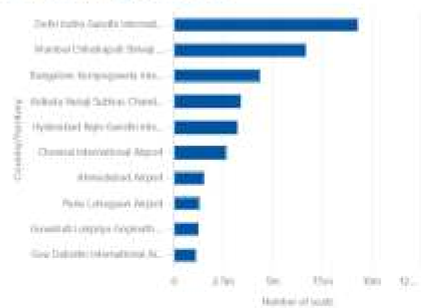
Source: CAPA - Centre for Aviation and OAG

India top ten hubs/bases/stations by system cargo payload (kg)
Week commencing 05-Nov-2018



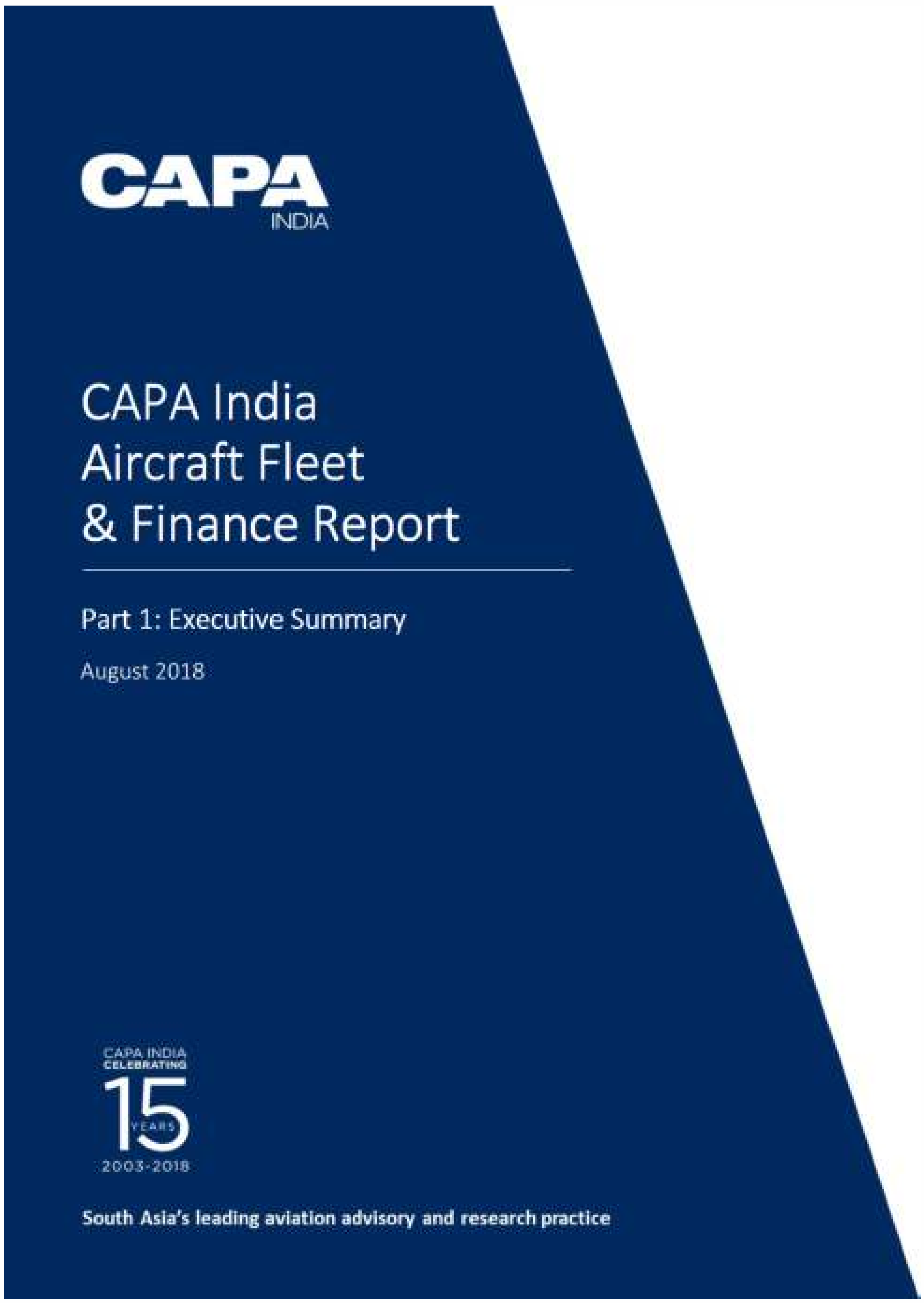
Source: CAPA - Centre for Aviation and OAG

Top ten airports for international arrivals into India cargo payload (kg)
Week commencing 05-Nov-2018



Source: CAPA - Centre for Aviation and OAG

ANNEX IX


CAPA INDIA

CAPA India
Aircraft Fleet
& Finance Report

Part 1: Executive Summary

August 2018

CAPA INDIA CELEBRATING 15 YEARS 2003-2018

South Asia's leading aviation advisory and research practice

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CAPA INDIA

Executive Summary

The unexpected recovery in Indian aviation since 2014 has changed the dynamics of the market and the demand for aircraft.

The sharp decline in fuel prices from late 2014 precipitated a marked change in the fortunes of Indian carriers. Financial performance was further assisted by increased aircraft utilisation, more effective revenue management, greater pricing discipline (especially for travel closer to the date of departure), and a relatively buoyant economy with GDP growth of around 7% per annum.

This favourable combination of circumstances resulted in record profitability for IndiGo; a remarkable turnaround for SpiceJet from a position of near closure; significantly improved financials for Air India Express; increased profits at GoAir; Jet Airways reported record profits in FY2016; and even Air India reported an operating profit. Meanwhile, other smaller carriers reported lower than expected losses.

Between 2015 and 2017, the Government of India increased its efforts to strengthen the aviation sector with the release of a National Civil Aviation Policy; the launch of the Regional Connectivity Scheme; plans to privatise Air India (which did not eventuate); and the implementation of certain provisions of the Cape Town Convention to provide greater comfort to lessors.

As a result of these positive developments, instead of pausing to regroup, consolidate and strengthen their position after several difficult years, most airlines decided to take advantage of the conditions to pursue aggressive expansion.

Positive market conditions have led Indian carriers to place bets on expansion on an unprecedented scale, with 700+ aircraft ordered since 2014 and more orders expected.

India's domestic market has grown at around 20% per annum for each of the last three years, and similar growth is expected in the current financial year. Meanwhile, international traffic has also grown steadily at 8-10% per annum in recent years.

With strong demand fundamentals and high liquidity in aircraft financing, airlines have taken advantage of the environment to place orders for more than 700 aircraft since 2014.

Meanwhile, the total order book has now crossed 1000 aircraft, making it the third largest in the world behind the United States and China. And CAPA expects that a further 100 wide bodies could be ordered within the next 12 months.

Firm aircraft orders placed by Indian carriers since 2014

Airline	Narrow bodies	Turboprops	Wide bodies	Total
IndiGo	250	50	-	300
SpiceJet	100	25	-	175
Jet Airways	150	-	-	150
GoAir	72	-	-	72
Vistara	50	-	6	56
Air India	20	-	-	72
TOTAL	**642**	**75**	**6**	**723**
	88.8%	**10.4%**	**0.8%**	

Note: Includes orders placed with lessors

Source: CAPA India research and analysis, CAPA Fleet Database

Total aircraft on order to Indian carriers

Airline	Narrow bodies	Turboprops	Wide bodies	Total
IndiGo	389	40	-	429
SpiceJet	160	25	-	185
Jet Airways	225	-	15	240
GoAir	125	-	-	125
Vistara	50	-	6	56
Air India	20	-	-	20
TOTAL	**969**	**65**	**21**	**1055**
	91.8%	**6.2%**	**2.0%**	

Note: Includes orders placed with lessors

Source: CAPA India research and analysis, CAPA Fleet Database

The large orders placed by Indian carriers are in part due to the positive outlook for the market, but also reflect the fact that most airlines face a strategic compulsion to keep pace with the market leader, IndiGo, in order to maintain competitive relevance. With IndiGo holding a domestic market share of more than 40%, and the second largest carrier at 15%, the market dynamics are increasingly a case of IndiGo versus the rest, with the LCCs significantly stronger than FSCs.

However, not all of these aircraft may be delivered. It is possible that some orders could be rationalised as the operating environment changes. Market pressures are expected to result in the industry consolidating over the medium term around three large LCCs and two FSCs.

India's fleet inductions are dominated by new aircraft.

Indian carriers prefer new aircraft and have largely met their requirements by placing order directly with manufacturers. Even most of the aircraft being take on lease e.g. by Air India, are brand new. IndiGo has recently been taking some older aircraft on lease, however these are mostly short-term inductions to provide replacement capacity for planned A320neo deliveries that have been delayed due to engine issues.

As a result, carriers benefit from lower fuel burn and maintenance costs, higher dispatch reliability and an improved customer proposition. The placement of large orders directly with OEMs also results in significant support from the manufacturer.

The higher fuel efficiency and reliability of new aircraft are particularly important factors in a market with a harsh operating environment, high fuel costs and less well-developed technical maintenance facilities. Achieving high levels of reliability in Indian conditions with older aircraft requires a considerable technical resource base, which is difficult and expensive to assemble in India.

Indian carriers will require an estimated USD50 billion of financing to support projected deliveries until 2027.

With around 100 aircraft to be delivered to Indian carriers each year for the next five years, this is by far the greatest volume of aircraft induction in the history of Indian commercial aviation

Projected fleet expansion represents a major opportunity for aircraft investors looking to deploy capital in new generation assets. However, despite the strength of underlying demand, operators in the Indian market face a number of challenges. On the cost front, Indian carriers pay some of the highest fuel taxation in the world and also incur taxes on aircraft leases. While on the supply side, infrastructure and skills shortages (particularly commanders) are potential constraints on growth.

CAPA INDIA

India's rapid fleet expansion has been possible because narrow body equipment is most suitable for the market, and this segment is relatively easily financed and available in the global market.

More than 90% of aircraft orders are for narrow bodies, with planned inductions of 5-7 aircraft per month through to 2027. The scale of these orders has been made possible by the availability of sale-and-leaseback financing for narrow bodies, which are prime investible assets in the global aircraft financing market.

Sale-and-leaseback margins expected to soften, but such transactions could still generate USD4-5 bn over 10 years.

Large orders enable carriers to secure greater support from the manufacturer and a more competitive price, increasing the margin earned on such transactions, and in turn providing critical capital for Indian carriers. These margins are expected to soften but could still generate USD4-5 billion at an industry level over the next decade.

Growth would have been more challenging if the market structure was skewed to regional aircraft or wide bodies.

The liquidity of narrow body assets in the global market has enabled Indian carriers to secure financing for their orders. Had the market structure been such that regional or widebody aircraft would better serve demand, fleet growth would likely have been much slower, given the different dynamics in financing such equipment.

Regional carriers - particularly start-ups with limited experience – face significant challenges. Even if they are able to lease equipment, the terms and conditions are often tough. Deposits and advance payments can be equivalent to as much as 12 months lease rentals, which can create cashflow challenges for small operators.

Although wide bodies represent just 2% of current orders, an additional 100 of the type are expected to be ordered over the next 12 months.

The two largest FSCs, Air India and Jet Airways, have been losing domestic market share and are become increasingly dependent on international operations.

In the highly price sensitive domestic market, the two largest full service carriers have struggled given their high cost structures and declining service levels. As a result, they have been increasing their focus on international operations. Over the last three years, Air India has launched several new point-to-point routes in Europe and the US, while Jet Airways has been focused on working with alliance partners over hubs in Abu Dhabi, Amsterdam, London and Paris. Jet Airways is placing increasing emphasis on its partnership with Air France-KLM and Delta, relative to that with its strategic investor, Etihad.

However, Air India and Jet Airways can expect to experience increased competition and a downward impact on market share on their international routes as well. In the low cost segment, IndiGo and SpiceJet are expected to increase narrow body international services whilst launching long haul, wide body operations in the next 12-18 months. GoAir and AirAsia India are also planning to commence international services. Full service carrier, Vistara will commence its international foray by deploying narrow bodies on regional routes, before going further afield with 787s. And with the possibility of bilaterals being liberalised from 2019 onwards to support increased inbound tourism, competition from foreign carriers could also intensify.

The failure of the Air India privatisation process brings near-term uncertainty to the carrier and the prospect of increased losses. And Jet Airways is expected to continue in the red and face challenges with fund raising.

As a result of weak balance sheets and limited local aircraft financing options, airlines have relied on well-developed global markets and legal structures which leverage aircraft value to finance orders.

Due to relatively high interest rates in India, and the limitations of the Indian banking system, airlines are largely dependent on foreign capital for financing deliveries of ordered aircraft. Sale and lease back transactions have been the mainstay for financing India's fleet, which largely consists of narrow body aircraft.

The recent exception to this is IndiGo, which has begun to reduce its share of aircraft on operating leases. Some aircraft are being brought onto their books, mostly ATRs being financed from cash reserves. IndiGo similarly plans to acquire 6-7 A320neos.

Although there are only limited wide body transactions, these have mostly been finance leases, although Air India has entered into some operating leases for 787s.

Indian carriers are not expected to face challenges with financing near-term deliveries due to low interest rates and high liquidity in financing.

The low interest, high liquidity environment, recovering global economic growth and strong capital markets should ensure that availability of financing for aircraft deliveries to Indian airlines remains buoyant in the near term. New investors continue to be attracted to aircraft investment platforms and vehicles by high returns, and it is possible that more private equity and hedge funds will enter the market. Although interest rates and fuel prices are rising, for now they remain within an acceptable range.

Since Indian aircraft inductions are primarily narrow bodies with low cost configurations, these are liquid assets which continue to attract financing. The strong cycle is expected to continue for the foreseeable future, however there are geo-political risks related to the Middle East and North Asia.

Despite the strength of the market, the sheer scale of deliveries means that Indian airlines may need to secure the participation of 25+ lessors each year.

Indian carriers are scheduled to take delivery of around 100 aircraft per annum for each of the next five years. Assuming that lessors are on average willing to place 3-4 aircraft each in the market, more than 25 lessors may need to take exposure to India each year. Despite the availability of aircraft financing, Indian airlines may be chasing lessors more than lessors chasing airlines.

In order to attract a larger pool of lessors to participate in the market, India will need to take steps to reduce the country risk profile.

Although India is a signatory to the Cape Town Convention, the treaty has not been fully implemented. As a result, lessors may seek to contain their exposure to any single Indian carrier. The government recognises that this impacts the country's risk rating and increases lease costs for operators. It has therefore taken steps to replicate some of the Cape Town provisions within the Civil Aviation Regulations e.g. the ability to repossess an aircraft within five days of deregistration.

However, since these regulations were introduced, they have not been well-tested with commercial airline repossessions. But in the case of some general aviation operators, the time taken has been significantly higher than five days. Such issues will become more relevant as and when the global market becomes tighter.

An Indian carrier is likely to set-up an in-house leasing structure similar to AirAsia or Lion Air.

To achieve greater control and flexibility of financing and deployment of large orders, at least one Indian carrier is likely to establish its own in-house aircraft leasing division.

The profitability of Indian carriers is fragile.

Indian carriers are extraordinarily sensitive to jet fuel prices, a result of the high taxation regime that magnifies global price changes. Other input costs are also high, including the cost of leasing aircraft. With structurally adverse cost structures and a high level of competitive intensity, the recent improvement in profitability is likely to be temporary, particularly as fuel prices continue to rise. For most carriers, the fuel price is already close to or at the break-even price. CAPA expects industry level profitability to be constrained in FY2019 relative to last year due to the twin impact of rising costs and lower yields due to rapid capacity induction. Full service carriers are likely to feel the impact more acutely.

Influx of capital into aircraft financing and competition for sale and lease back deals has depressed returns for lessors.

The intense competition among lessors, driven by the influx of both capital and new players, has depressed returns. The sale-and-leaseback market was the key focus for most lessors, and capital in this market segment had increased manifold as new players achieved portfolio growth via such transactions while waiting for their deliveries.

To manage profitability, some of the traditional sale-and-leaseback focused lessors have migrated upstream to the primary market, ordering aircraft from manufacturers. Amongst other reason, this has also contributed to merger and acquisition activity as the scale needed to compete in the primary market is greater.

While consolidation is the predominant trend, the growing appeal of aircraft as an investment, coupled with leasing executives tapping such investor interest to establish new entities, has resulted in a proliferation of lessors, some of which offer a level of genuine differentiation in their business strategies.

Global demand for aircraft is strong, but the value of financing required will not continue to grow at the rates expected by several market players.

Although some of the major participants in the market forecast rising values of the market for new deliveries, the challenges in increasing production rates will mean that the market is unlikely to grow appreciably beyond its current level of USD122 bn in the years leading to 2020. This further caps the impact of risk events, should they materialise.

Despite the attention given to Chinese investments in aircraft finance, the reality is that most of this is driven by the need to support the growth of the Chinese fleet.

Should any adverse economic event occur, the slowdown in the Chinese air transport market and consequently the demand for aircraft, would partly offset the potential withdrawal of Chinese capital from aircraft finance. Investment in the fleet of other markets from China is less than that commonly believed. In the short term however, depending on the speed and severity of the adverse economic event, there would be an impact on the global market for aircraft financing before it adjusts to the new level of capital flow.

Changing industry structure means that Indian carriers need to rethink their aircraft financing strategy.

The priorities and business strategy of some of the lessors who have traditionally supported the growth of the Indian fleet are changing. Although competition among lessors for sale-and-leaseback deals is considerable at present, increasing deliveries to carriers that rely on such transactions for financing their neo and MAX aircraft in the years to come mean that it will be a buyers' market where airlines need lessors more than lessors need airlines for such aircraft acquisition opportunities.

Coupled with the smaller volume of capital pursuing such opportunities, relative to the market of that time, some Indian carriers may face medium term challenges in securing lessors to finance their deliveries. Carriers looking to finance A320neo deliveries may be less favourably placed vis-à-vis those looking to finance 737 MAX equipment.

Nearly 50% of all A320neo aircraft to be delivered over the period till 2027 - based on the current orderbook - will be to carriers that have financed at least a third of their past deliveries by sale and lease back transactions. In the case of the 737MAX, that figure is around 35%. After applying a range of qualifying criteria, the emerging assessment is that a larger portion of the A320neo deliveries is to airlines that tend to rely on sale-and-leaseback transactions to finance a substantial part of their fleet.

Another pertinent factor is that the distribution of orders across carriers is more uniform for the 737, whereas the A320 orderbook has more large orders from a few customers who might offer similar risk-return profiles to prospective lessors.

While lessors perform due diligence on airlines, few airlines do rigorous due diligence on lessors.

Airlines should view lessors as entities that are prone to risk, just as other classes of financial entities. In the race to enhance returns and grow the portfolio, leverage levels have increased for several prominent lessors. Further, these lessors also have an increasing portion of capital requirements met by short term credit. For lessors relying on recurring refinancing, adverse events and shocks can potentially lead to a liquidity squeeze.

At present, the state of the secondary market for aircraft (with leases attached) is healthy. Securitisation activity has accelerated with robust appetite for such issuances and acceptance of a wider variety of assets in the pool. Going forward however, the declining size of the middle order in the lessor ecosystem, which traditionally buys aircraft with leases originated by the leading lessors that seek to recycle capital for upcoming deliveries, and rising interest rates that may result in other asset classes becoming more compelling, could reduce the liquidity in the markets for aircraft assets and aircraft lease securitisations.

CAPA INDIA

CAPA Aircraft Advisory

CAPA Aircraft Advisory provides a flexible range of services to assist our clients in relation to aircraft acquisition, financing, leasing, selling or asset management:

- Aircraft economic performance studies and financial modelling
- Asset management and risk monitoring for banks and lessors
- Introductions for to providers of financing and re-financing on competitive terms
- Mission requirements analysis to identify suitable equipment
- OEM and lessor liaison and negotiation support
- Structuring of terms and conditions in line with global benchmarks
- Wet leasing placement support and opportunity identification

CAPA Aircraft Advisory experience includes:

- **South Asian flag carrier:** We were appointed by the airline's aircraft acquisition committee to support its fleet modernisation plans. The study involved a detailed review of key operating and financial characteristics of Airbus and Boeing aircraft as presented in the manufacturers' proposals. In parallel we provided an evaluation of the carrier's business and strategic plan.
- **Start-up LCCs and Regional Airlines:** CAPA has led discussions or negotiations on behalf of multiple start-up carriers, with aircraft manufacturers, including Airbus, ATR, Boeing, Bombardier and Embraer with respect to their acquisition and/or leasing of aircraft.
- **Very Light Jet business:** CAPA was engaged by a private equity fund to conduct due diligence on a charter business model based on the induction of a new Very Light Jet (VLJ) aircraft type. Our role was to apply our knowledge and experience of general aviation to critique the robustness of assumptions and strategy related to revenue and demand, aircraft operations, regulatory issues, base selection, availability of infrastructure and validity of costs.
- **Business Jet Acquisition:** Two leading business houses appointed CAPA to advise on the proposed acquisition of pre-owned business jets. Our mandate was to conduct a detailed needs analysis of the company travel patterns to determine the appropriate mission requirements. This led to the identification of suitable aircraft types and a global search of available pre-owned equipment within these types.

For more information or assistance please contact:

Neeladrinath Sarangi
Senior Manager & Practice Lead Aircraft Advisory
nsarangi@capaindia.com

Global Market for Aircraft Financing

Note: Data as at 31-Dec-2017

Market for finance

Demand for air travel and aircraft

Airbus and Boeing forecast that global air traffic will grow at a CAGR of 4.5% and 4.7% respectively over the 20 years to 2036. Asia Pacific is projected to account for most of this growth, led by the sustained expansion of the Chinese market, representing the most significant structural trend over the next two decades. IATA expects China to overtake the United States as the world's largest air transport market by 2022.

Beyond China, the other market that will make a significant contribution to regional and global growth is India, which CAPA estimates will become the third largest in the world by in the first half of the 2020s. ASEAN and North Asia will also be strong performers. As a result Asia Pacific will further consolidate its position as the world's largest air transport region.

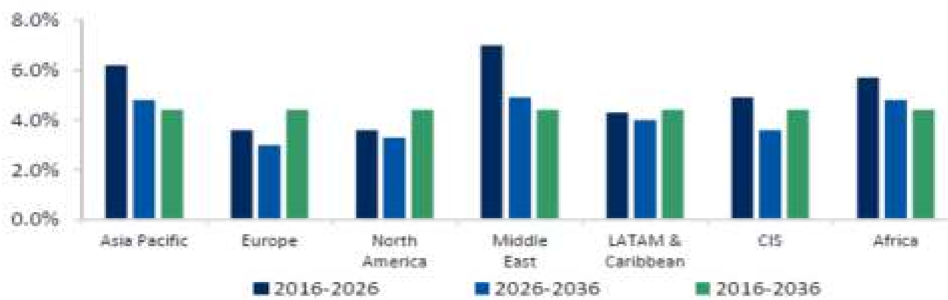
North America, the second largest region, will also be the slowest growing (with a CAGR of 3%). However, Europe, despite its relative maturity, is expected to see faster growth, driven in part by increasing economic activity in Eastern Europe. As a result, Europe is expected to overtake North America to become the second largest region.

Africa and the Middle East are expected to experience above average traffic growth on the back of economic development, tourism and trade. In the Middle East, risks to growth are significant, as geopolitical instability and limited economic diversity may act as constraints. Africa remains a small air transport market in absolute but has great potential subject to economic development and regional cooperation. Much will depend upon the role that China plays, both as a provider of capital and investment, and as a consumer of the continent's natural resources. Both Africa and the Middle East have much larger inter-regional as opposed to intra-regional traffic flows.

The Latin American market is a mixed bag at present, with political and economic volatility affecting different countries at different times. Boeing and Airbus differ in their assessment on the prospects for long term traffic growth, with the former expecting the region to grow significantly faster than the world rate and the latter pegging its forecasts to levels below the global average. The emergence of trans-national brands through consolidation, continuing deregulation, and capital investments by strategic investors are some of the factors in Boeing's more optimistic forecast.

Among inter-regional flows, North America-Europe is expected to remain among the largest, despite its relative maturity. The major role that hubs and super-connector carriers in the Middle East play in global flows, are expected to sustain over the coming decades, subject to some of the key risks highlighted earlier. The continuing rise of China and India will see their international traffic grow at relatively high rates. Growth in China's international flows is likely to be broader-based than that of India, partly due to more responsive policy action and the larger scale of Chinese carriers with the resources to pursue global expansion.

Figure 1: Intra-regional traffic flow projections



Source: Airbus, CAPA India research and analysis

Based on the momentum of traffic trends, Airbus estimates that 34,900 new aircraft will be inducted into commercial airline fleets from 2017 to 2036, 98% of which (34,170) will be passenger aircraft and the remaining 2% (730) being freighters.

Table 1: New aircraft demand - passenger and freighter equipment

Region	2017-2026	2027-2036	2017-2036	Share of New Deliveries (2017-2036)
Africa	350	700	1,050	3%
Asia-Pacific	6,140	8,140	14,280	41%
CIS	340	860	1,200	3%
Europe	2,640	4,180	6,820	20%
Latin America	940	1,730	2,670	8%
Middle East	1,260	1,270	2,530	7%
N. America	2,360	3,260	5,620	16%
Freighters	410	320	730	2%
World Total	14,440	20,460	34,900	100%

Source: Airbus, CAPA India Research and Analysis

Airbus expects Asia Pacific to account for 41% of new aircraft inductions, while the United States and Europe will collectively represent 36% of deliveries. Narrow body and wide body aircraft are each expected to account for around 40% of value of new deliveries, however narrow bodies will constitute 71% of aircraft.

Nearly two-thirds of the current fleet is expected to retire over the next 20 years, by which time the in-service fleet will have doubled.

In regions with mostly emerging economies, the majority of deliveries are for network growth by new narrow body aircraft. The exception to this is the Middle East, where 80% of deliveries will be for growth by new wide body aircraft.

Boeing's demand forecasts are higher, with 41,030 deliveries over the 2017 to 2036 period. However, there are differences in the aircraft segments covered in the forecast by Boeing and Airbus. With respect to passenger aircraft, Airbus' forecasts are for 100 seats and above whereas Boeing forecasts are for 30 seaters and above. The combined passenger and freighter fleet base of both forecasts are different, Boeing having a larger base of 23,480 aircraft vis-à-vis Airbus' 20,500. Further, Boeing anticipates a higher rate of global air traffic growth as mentioned in the previous section.

Boeing expects three quarters of the current fleet to retire over the period. About 40% of new deliveries are expected to be made to operators in the Asia Pacific, 21% to North America and 18% to Europe. The OEM is particularly bullish on Asia Pacific demand and expects a greater portion of demand to be for narrow body aircraft across all regions, except the Commonwealth of Independent States. While some of this comes from Boeing's coverage of sub-100 seaters, most of this is attributable to its views on network development and the role of narrow body aircraft.

In contrast, Airbus expects a much greater number of wide body deliveries, particularly to the Asia Pacific region. Both OEMs expect the continued expansion of aviation in the Middle East, with Boeing expecting substantially more deliveries, most such aircraft being single-aisle. Boeing anticipates more wide-body deliveries to North America and the Middle East.

Network expansion in many markets is likely to be driven by new routes becoming technically feasible or viable due to technology evolution. Newly liberalising aviation markets can make significant contributions to traffic growth. However, market access challenges may remain for longer than expected.

Boeing expects that the world freighter fleet will increase by two-thirds from its current size of 1,810 aircraft, to 3,020 aircraft by 2036. More than half of this increase is likely to come from conversion programs, with single-aisle conversions accounting for approximately 70% of such conversions. Narrow body freighter aircraft, may account for 40% of the worldwide freighter fleet by 2036, up from 34% in 2017. The OEM forecasts 920 freighter deliveries over the next two decades.

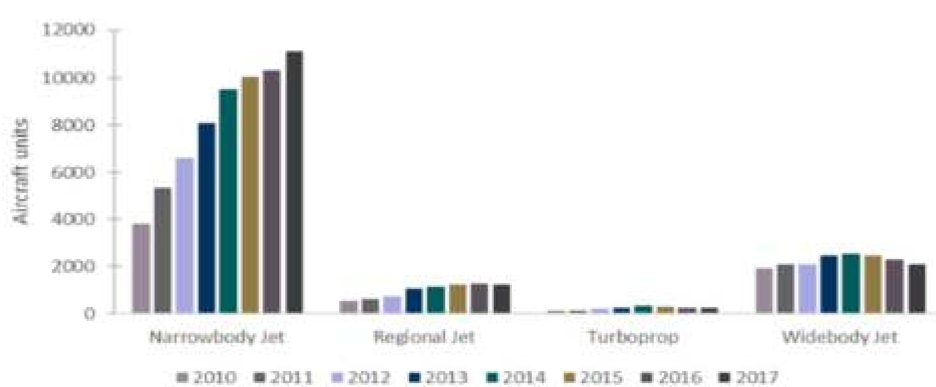
Airbus expects fewer freighter deliveries, at 730 aircraft, over the same period but predicts robust growth in the business of Asia-based freighter operations. The freighter fleet of the region is expected to more than double. The smaller fleet in the Middle East is also expected to undergo rapid growth. The majority of the freighter fleet in both regions are with the cargo divisions of the big airline groups. The other source of demand for new freighter aircraft are from the renewal of the large North American air cargo express fleets. Net fleet growth would be relatively less than in Asia, but replacements for the world's largest fleet mean that demand for new freighters would be substantial. The North American fleet is expected to remain the largest in 2036.

Airbus forecasts much fewer narrow body conversions than its US based counterpart. The European OEM expects a greater segment of widebody freighter demand to be met by conversions and forecasts fewer widebody freighter deliveries over the next two decades. Airbus expects approximately 50% fewer narrow body conversions and nearly double the number of wide body conversions as that of Boeing.

Order book and delivery schedule

The global commercial aircraft order book is at an all-time high. The delivery backlog of mainline aircraft families stretches well beyond the highs of previous order cycles. Almost every year in the current cycle has witnessed an increase in the backlog, despite expanded production rates and cautionary tones from some quarters in the industry.

Figure 2: Orderbook growth over the years

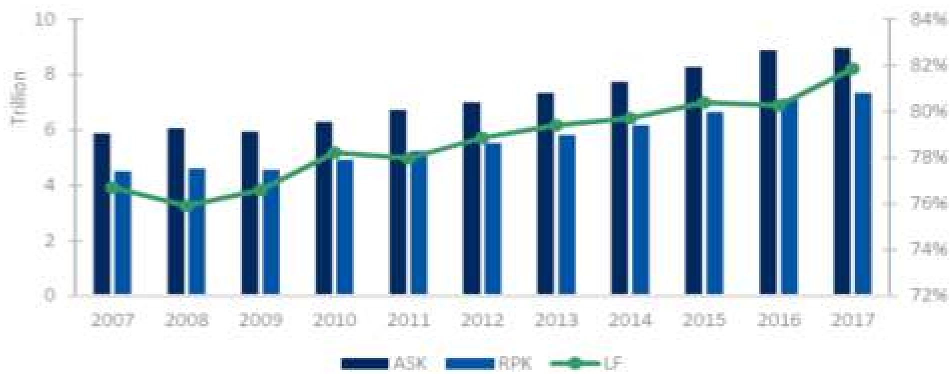


Source: CAPA India Research and Analysis, CAPA Fleet Database Note: Firm orders only as at 31-Mar

The growth in the order book is largely driven by the demand for narrow body aircraft.

Global traffic growth has been robust and ahead of capacity resulting in a 5 percentage points increase in the load factor, which reached 82% in 2017. Capacity expansion has resulted from a combination of fleet growth, higher aircraft utilisation and increased seat densities.

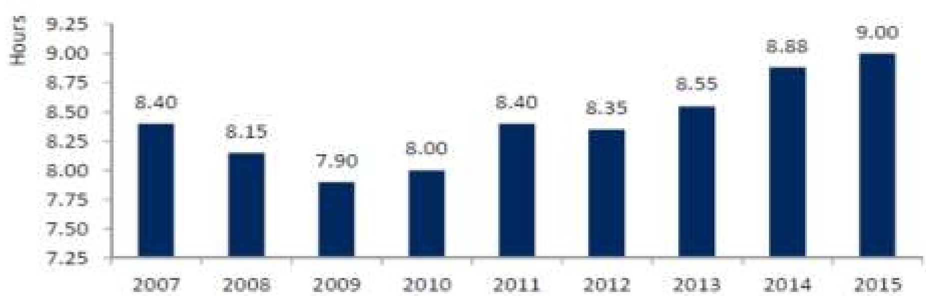
Figure 3: Worldwide scheduled capacity and traffic



Source: ICAO, CAPA India Research and Analysis

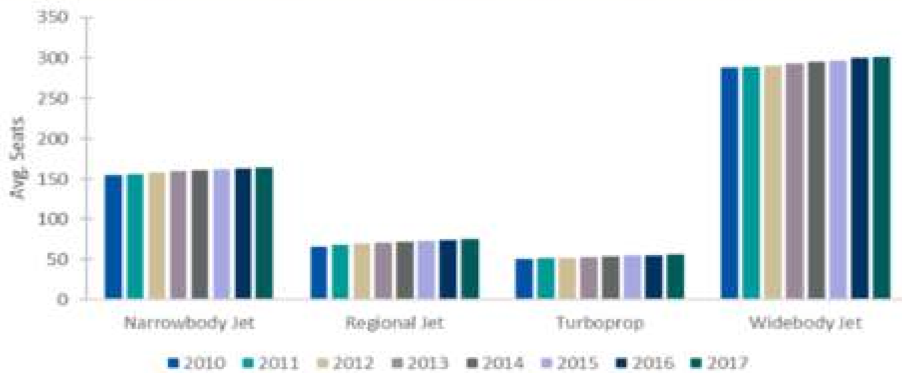
Note: 2017 number annualised

Figure 4: Worldwide average daily utilisation



Source: ICAO, CAPA India Research and Analysis

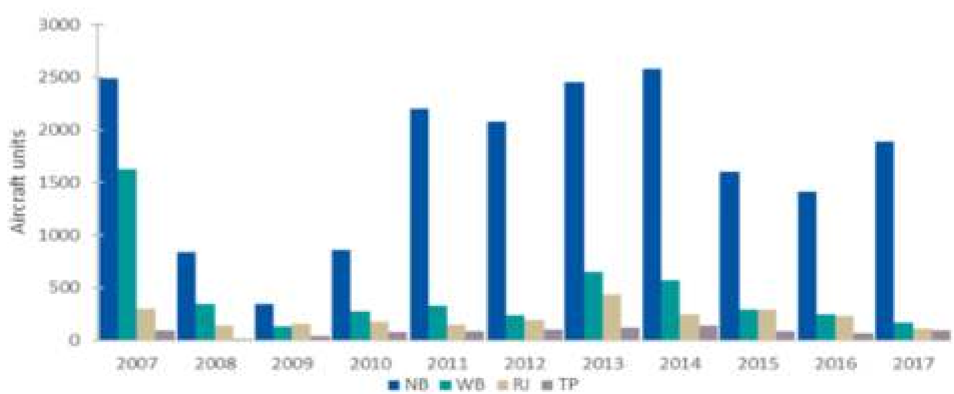
Figure 5: Average seats by aircraft category for global operating fleet



Source: CAPA India Research and Analysis, CAPA Fleet Database Note: In service fleet only as at 31-Dec

The large order books are a reflection of the market's adjustment to demand outpacing supply. While the order book and delivery backlog have indeed been growing, the pace of orders has declined considerably in recent years. Ordering activity was most significant in 2013 and 2014 and has been more subdued since then.

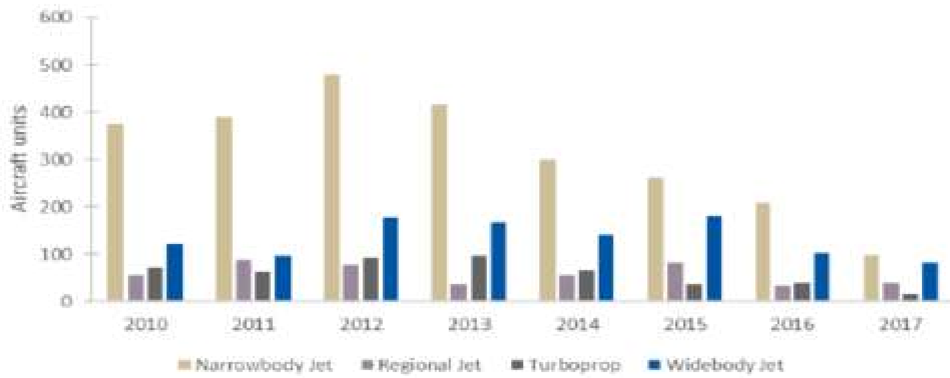
Figure 6: Orders placed per annum 2007-2017



Source: CAPA India Research and Analysis, CAPA Fleet Database Note: Firm orders only. As at 31-Dec each year

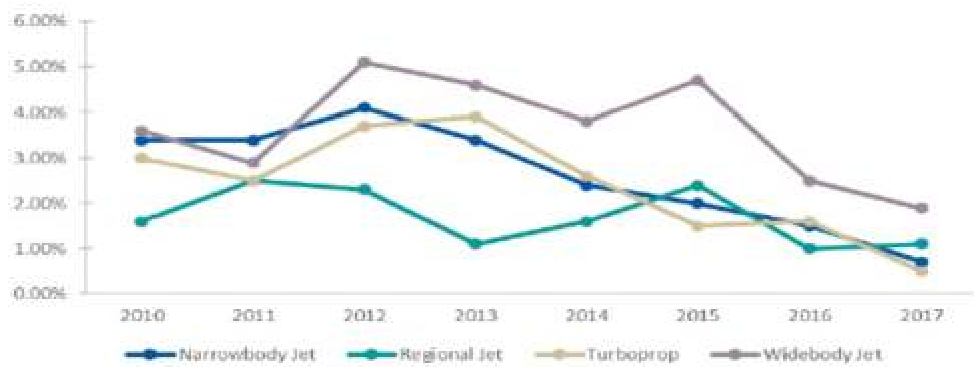
In the high fuel price environment prior to 2015, carriers planned to meet this demand with new technology fuel-efficient aircraft such as the A320neo, 737 MAX and the 787. In the benign environment since 2015, the efficiency draw of new technology has been moderated by the cost of fleet renewal for most carriers. The rate of retirements across aircraft categories has slowed.

Figure 7: Retirement of aircraft per annum 2010-2017



Source: CAPA India Research and Analysis, CAPA Fleet Database Note: As at 31-Dec of each year

Figure 8: Retirements as a percentage of in service fleet



Source: CAPA India Research and Analysis, CAPA Fleet Database Note: As at 31-Dec of each year

A strong delivery stream of new aircraft and deferred retirements of existing aircraft has resulted in a modest supply glut of equipment, some of which is stored as operators see greater value in the prospects of reactivation or asset sales.

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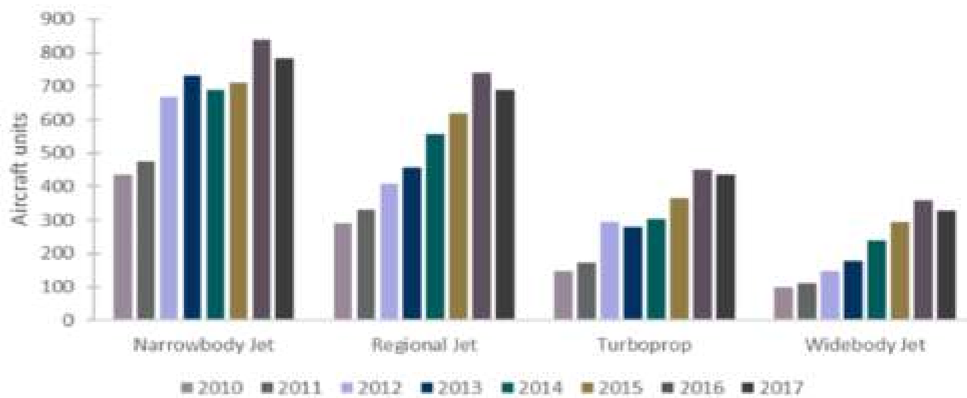
Figure 10: Aircraft in storage 2010-2017



Source: CAPA India Research and Analysis, CAPA Fleet Database

Note: As at 31-Dec of each year

Figure 11: Aircraft in storage as a percentage of the in-service fleet

Source: CAPA India Research and Analysis, CAPA Fleet Database

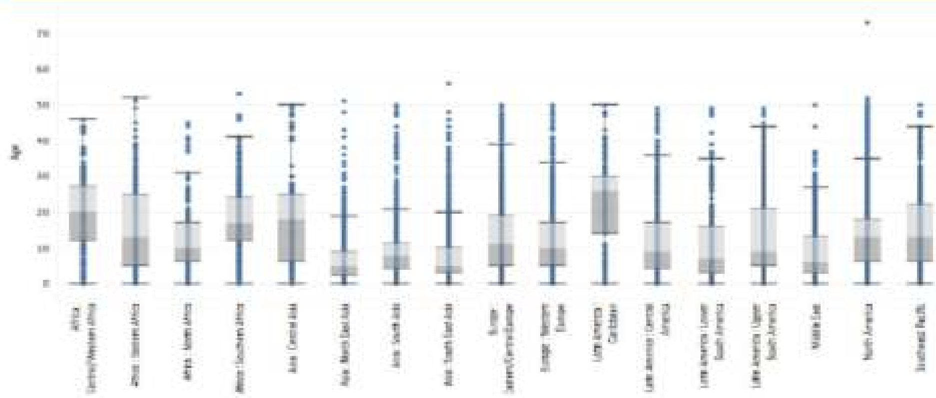
Note: As at 31-Dec-2017

Figure 12: Aircraft in storage by aircraft type

Source: CAPA India Research and Analysis, CAPA Fleet Database

Demand for new aircraft is led by Asian operators. This is less prevalent in Central Asia, where thinner markets may not support the economics for young fleets. Carriers in North America and the Caribbean have relatively older fleets.

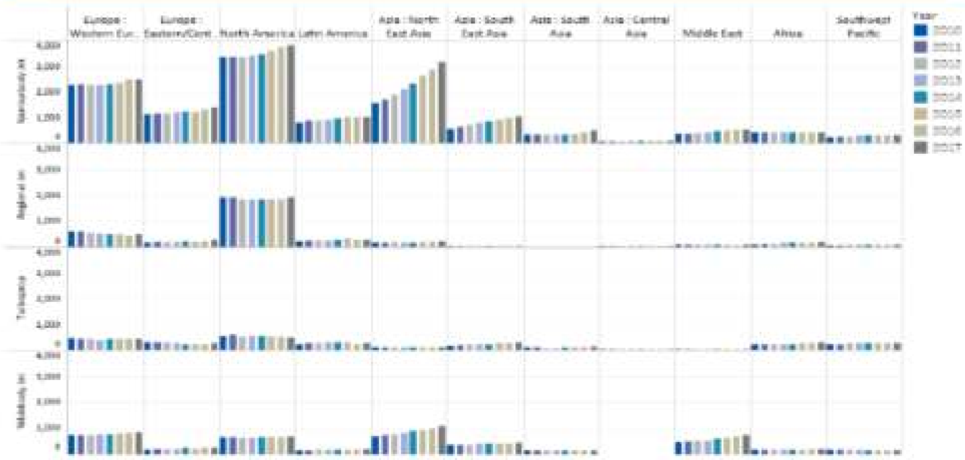
Figure 13: Distribution of in-service fleet by age



Source: CAPA India Research and Analysis, CAPA Fleet Database

New deliveries to North American operators have helped in renewing their fleets which have been stable in size, reflecting the maturity of the market. Asian fleets have been growing substantially, led by China.

Figure 14: Growth of in-service fleet



Source: CAPA India Research and Analysis, CAPA Fleet Database

Carriers in North East Asia are driving the increasing share of narrow body aircraft types in global traffic flows. Narrow body capacity exceeds 50% of global scheduled capacity and its share is expected to increase further. The size of the narrow body fleet in North East Asia is the second largest in the world and is likely to exceed that of North America as domestic China becomes the single largest aviation market over the next few years.

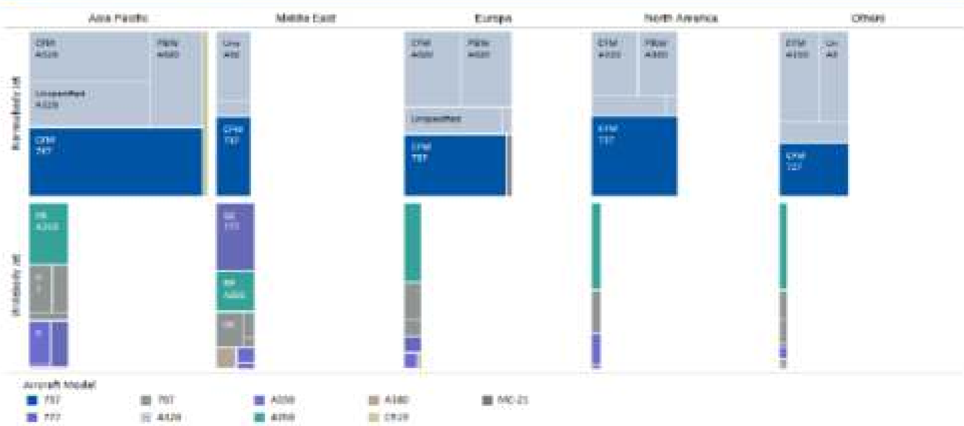
In this context of rapid traffic growth in a number of markets, particularly in Asia, and replacements for mature markets in North America and Western Europe, the size of the current order book is reasonable.

The increasing ease of financing has accelerated fleet growth, fleet renewal and fuelled speculative ordering. However, the fundamentals of aircraft demand are strong, even with the supply glut of young equipment of some mainline types. The risks to the order book are China and geopolitical shocks in North East Asia and the Middle East. Adverse economic and political developments in these regions will have an acute impact on the demand for aircraft.

Given that the current order book is worth several years production at current production rates, aircraft makers would still have time to adjust to modest shifts in demand. The pipeline of aircraft investment opportunities for lessors would continue to be robust. And the aircraft financing market would continue to expand, albeit a slower pace.

The unprecedented size of the current order book is likely to represent the 'top' or be 'near the top' of the cycle. Net growth in orders is less likely going forward as most operators have accommodated technology evolution, and adjusted fleet plans for high and low fuel price scenarios and traffic potential. Further, production rates have increased considerably over the past few years while availability of pre-owned, mainline assets has also increased.

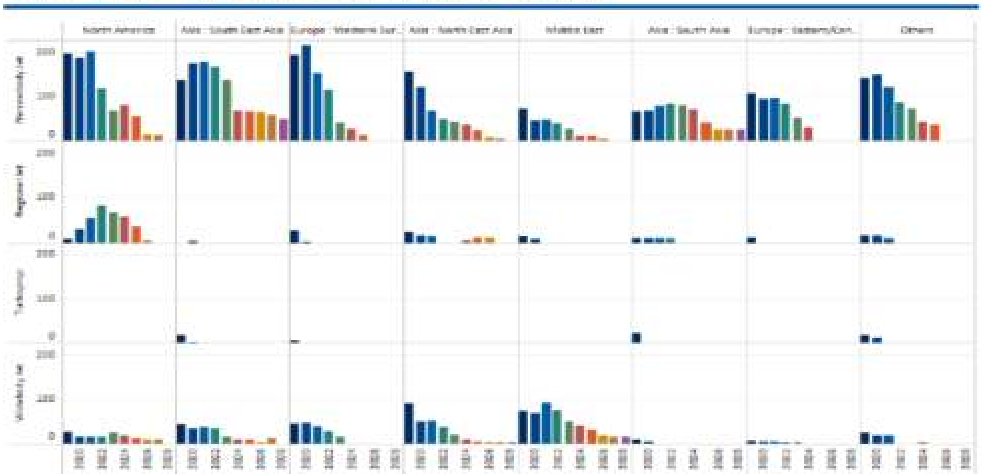
Figure 15: Current firm orders for narrow body and wide body equipment by engine manufacturer



Source: CAPA India Research and Analysis, CAPA Fleet Database

Distribution of aircraft and engine types in the order book is balanced, with the scale of North American and European orders being comparable to that of the rapidly growing Asian carriers. This is less so in the wide body space, where orders from the Middle East and Asia, account for the bulk of the orderbook. The 777, A330 and A380 production lines are at some risk as orders are concentrated among a relatively smaller set of operators. The risk profile of the 777 programme may improve as the 777X product moves closer to certification and delivery.

Figure 16: Delivery schedule of current firm orders

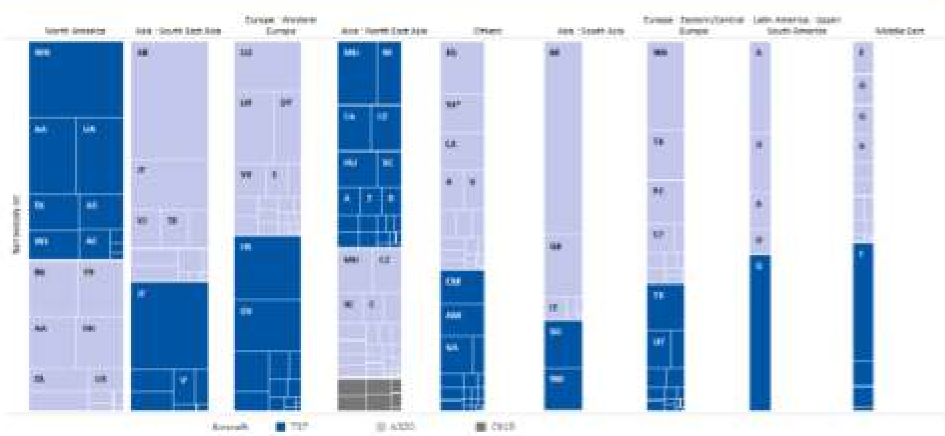


Source: CAPA India Research and Analysis, CAPA Fleet Database

Although the China-led growth of the North East Asia fleet has been dramatic, its share of remaining deliveries is relatively modest. In the important narrow body category, operators in South East Asia account for a greater share than those of the North East. The short-term narrow body pipeline is more robust due to the large share of North American and European operators. Risks are higher in the widebody delivery line with heavy concentration towards Middle Eastern and North East Asian operators.

Among narrow body families, the 737 has a smaller share in most markets while the A320 has a large portion of the order book coming from a relatively small group of customers. Most of these customers are LCCs which have gained substantial share of the markets in which they operate.

Figure 17: Current firm narrow body orders for disclosed customers



Source: CAPA India Research and Analysis, CAPA Fleet Database

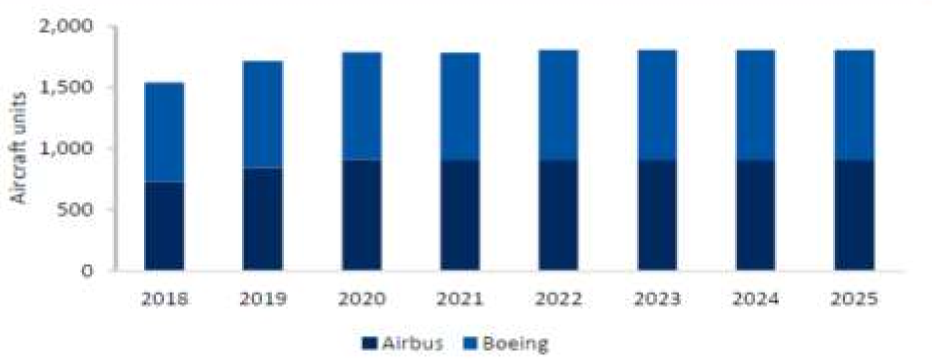
Figure 18: Firm orders from top customers as a percentage of total order book

Source: CAPA India Research and Analysis, CAPA Fleet Database

Production

The growing backlogs have led aircraft manufacturers to increase production rates. Airbus has opened new lines and enhanced existing assembly facilities in the US and China, to fast track deliveries. Boeing has commenced assembly of the 787 Dreamliner in a second facility in the US, which also supports the 737 MAX programme, and will be supporting the 777X programme in the future.

Figure 19: Total new aircraft to be manufactured



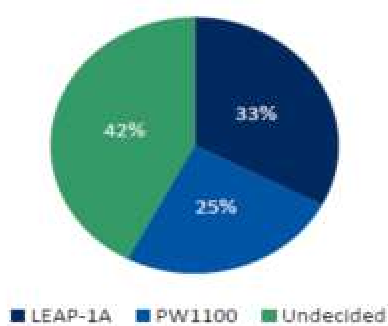
Source: CAPA India Research and Analysis Note: Freighters included for 777

Production rate increases in wide body programmes are also being contemplated for the popular 787 and A350 families. Airbus had announced a production rate target of 60 per month for the A320, and Boeing had similarly stated a target rate of 57 per month for the 737 MAX.

Deliveries of A320neos have been facing delays due to challenges with the Pratt & Whitney GTF engine. CFM, the engine manufacturer of the alternative powerplant, supplies engines to Boeing and COMAC as well. Ramping up production at CFM for both the A320neo and the 737 MAX would be a challenge.

With both engine manufacturers having their own priorities, Airbus' production target may be ambitious. The engine unspecified portion of the A320neo orderbook has become the largest segment and will make production shifts difficult.

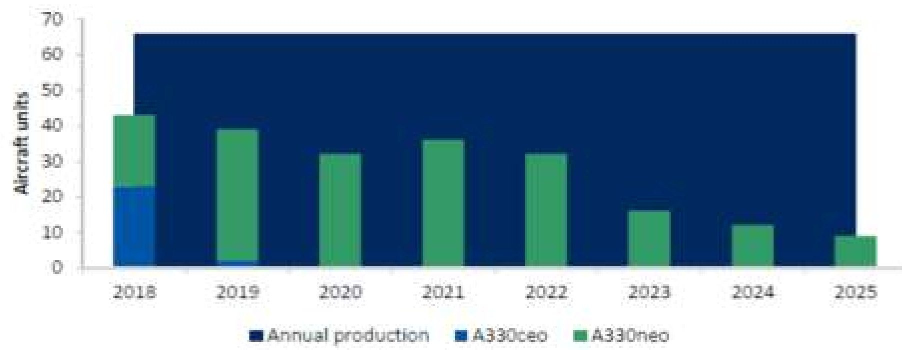
Figure 20: A320neo orders – Engine selection



Source: CAPA India Research and Analysis, CAPA Fleet Database

A widebody programme that is undergoing transition is the A330. Due to the slowdown in ordering activity for the A330 family, the production rate was reduced recently to facilitate a smooth transition. However, the lower production rate is still high relative to the order backlog for this aircraft family. If Airbus fails to bring in more orders, a further reduction in the production rate can be expected.

Figure 22: A330 family – Scheduled deliveries and the current production rate

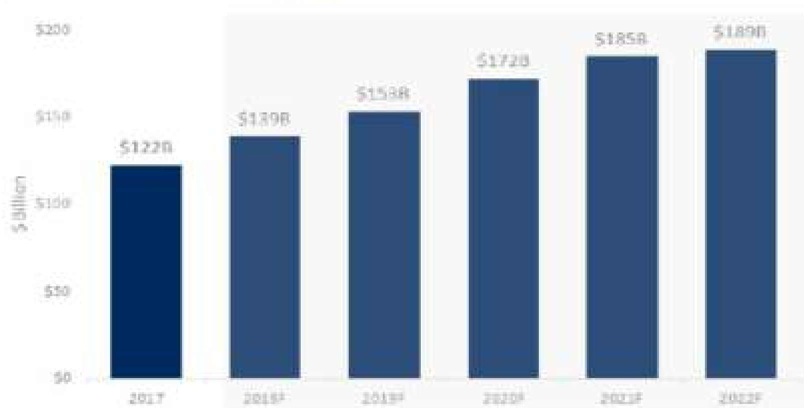


Source: CAPA India Research and Analysis, CAPA Fleet Database Note: Firm orders only

Financing new deliveries

With strong and sustained traffic growth, a revival in industry profitability and the introduction of several new technology aircraft programmes, the value of new deliveries financed has been increasing over most of this decade. Boeing expects this growth to not only continue, but accelerate over the next few years. The OEM forecasts the size of this market to reach nearly USD190 bn by 2022.

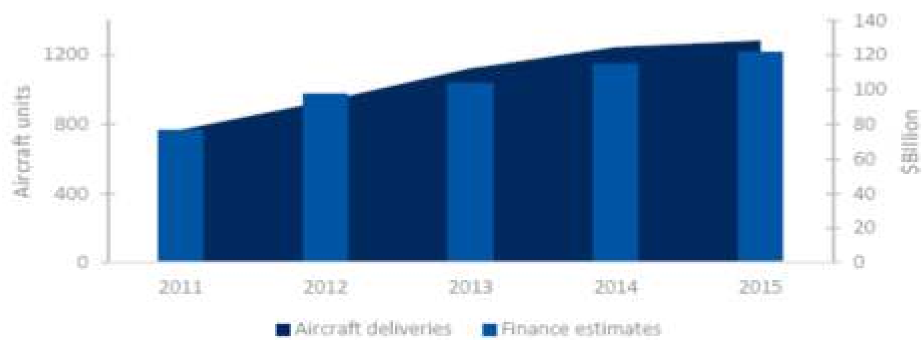
Figure 23: Aircraft funding requirement forecast



Source: Boeing, CAPA India research and analysis

However, there has been some moderation in the pace of growth of financing since 2015. This is largely due to the declining production in legacy widebody programmes and the modest increases in the production rates of mainline narrow body aircraft by the two main equipment makers. The large increase in financing in the period from 2011 to 2015 was driven by significant ramp up of the production of in-demand narrow body and wide body types.

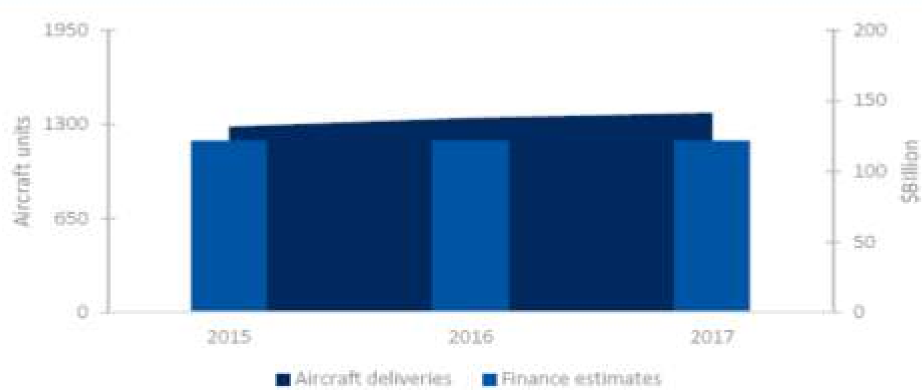
Figure 24: Annual production of major types and value of new deliveries financed



Source: Boeing, CAPA India research and analysis Note: Select aircraft models only

After the initial increases, the production rates of both A320 and 737 families have expanded at a slower pace since 2015, despite OEMs' plans to manufacture 55 to 60 aircraft per month. Boeing has been slightly more conservative in its commitment to production rates. With the changes in Airbus' leadership, a revision of the rate target cannot be ruled out. The slowing in the pace of rate growth is indicative of the challenges that manufacturers will face in attempting to deliver 60 aircraft every month.

Figure 25: Annual production of major types and value of new deliveries financed



Source: CAPA India research and analysis, CAPA Fleet Database

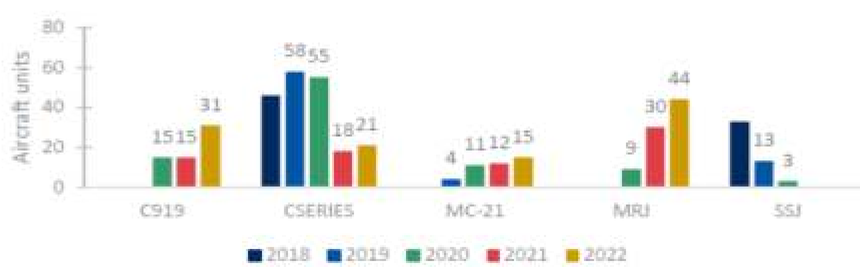
Note: Select aircraft models only

With further significant increases in the rate of production being less likely and the possibility that the peak of the cycle has passed - however soft such a reversal may be - the volume of financing for new aircraft deliveries is unlikely to expand substantially beyond current levels in the intermediate term.

The arrival and impending arrival of new aircraft types will add to the volume of finance required. In the single aisle segment, several aircraft types having capabilities spanning that of regional jets and traditional 150+ seat narrow body aircraft have emerged.

Deliveries from the 777X program will add to the volume of financing required, but that additional requirement will play out in the early part of the 2020s. In the near term, the deliveries of new types of single aisle aircraft families will be relatively modest but are expected to grow over time.

Figure 26: Delivery timelines of new aircraft families

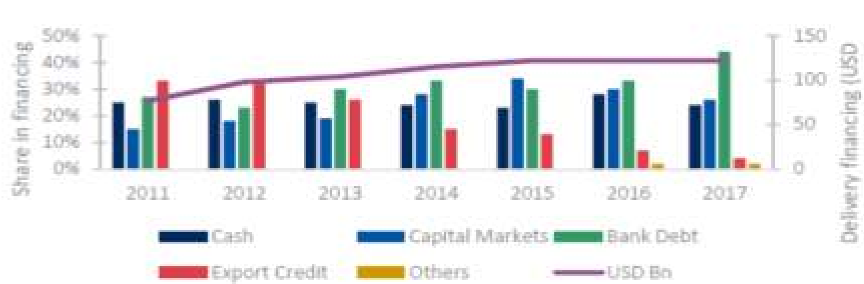


Source: CAPA India research and analysis, CAPA Fleet Database

Note: Firm orders only

Capital markets have provided an increasing share of the funding for purchasing aircraft from 2011 until 2015 to reach around one-third. In 2016 and 2017 banks provided the largest share of capital deployed in new aircraft assets.

Figure 27: Sources of financing



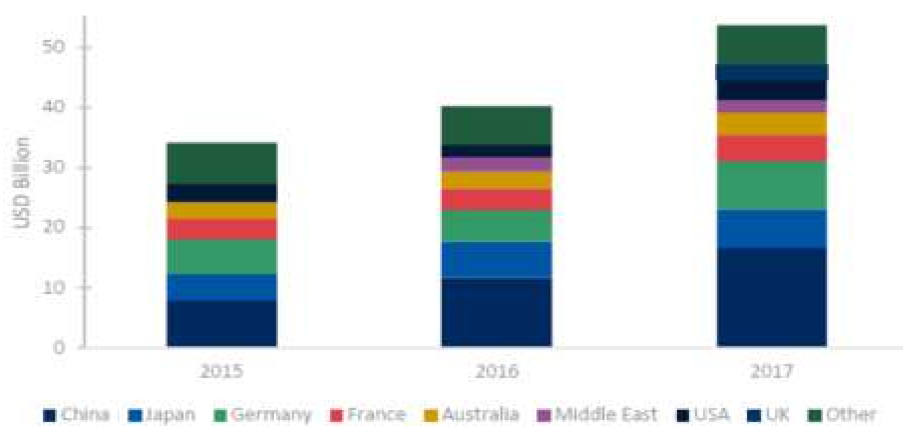
Source: Boeing, CAPA India research and analysis

This re-ordering is led by the Chinese banks, which have supported both the growth of the Chinese operating fleet and affiliated lessors. China is the largest recipient of new aircraft for several years and local credit has financed much of these deliveries.

Figure 28: Deliveries to top 5 countries

Source: CAPA India research and analysis, CAPA Fleet Database

Figure 99: Increasing share of bank debt



Source: Boeing, CAPA India research and analysis

Capital markets are more relevant for deliveries to North America, Europe and increasingly, to other regions. They were an increasingly important source for lessors in the years following the economic crisis at the end of the 2000s, but have somewhat diminished in their role in financing the delivery of lessor-ordered aircraft as lessors with large and supportive parent conglomerates secured access to large volumes of low cost credit. Nonetheless, capital markets remain a major provider of capital for lessors.

For carriers in North America and Europe, these markets have allowed them to raise large volumes of competitively-priced capital that can supplement accruals from profitable operations for funding fleet renewal initiatives.

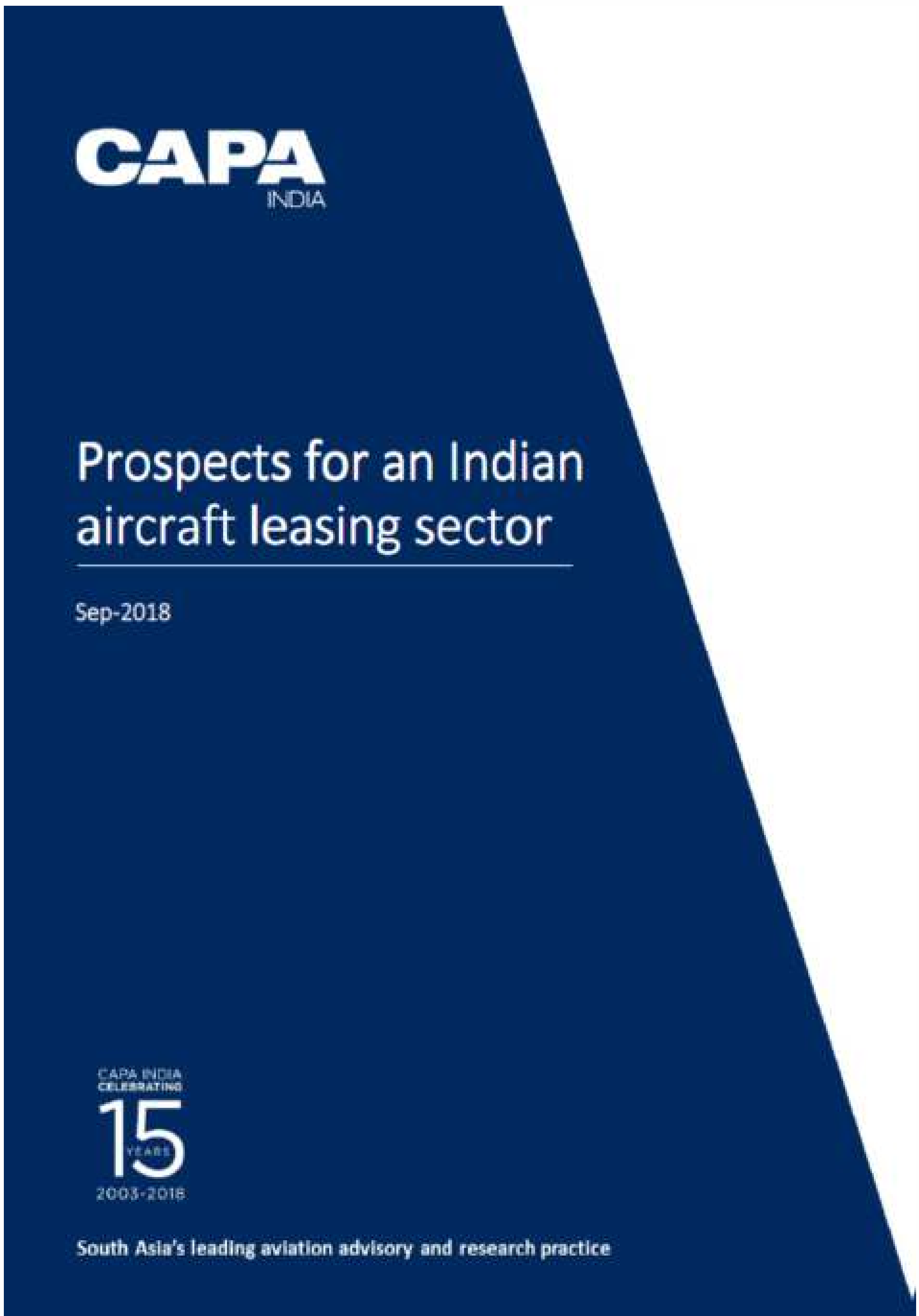
Figure 30: Select EETC issuances

Airline	Issue	Purpose	Aircraft
Turkish Airlines	USD328 mn	New acquisition	777s
Emirates	USD630 mn	New acquisition	A380s
Turkish Airlines	JPY 11.9 bn	New acquisition	A321s
LATAM Airlines	USD1.0 bn	New acquisition	A321s, A350s, 787s
Air Canada	USD714 mn	New acquisition	777s
British Airways	USD927 mn	New acquisition	A320s, 777s, 787s

Source: CAPA India Research and Analysis; Indicative list only (non-exhaustive)

In the benign current environment, the role of export credit has understandably been declining, and in some cases was withdrawn in 2016. Without such support, OEMs are creating their own credit enhancement structures to enable weaker airlines to gain access to bank financing. A notable development is the formation of the Aircraft Finance Insurance Consortium. The consortium of several large insurance giants, enhances the credit of airlines with the provision of non-payment insurance cover.

ANNEX X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Prospects for an Indian Aircraft Leasing Sector

As an emerging aviation power, India is exploring the need to establish home-grown leasing options

India has the world's third largest aircraft order book behind the US and China, with more than 1000 aircraft on order to commercial airlines, valued at around USD50 billion. The vast majority of these aircraft will be taken on lease from offshore lessors.

By 2050, India's commercial airline fleet is expected to exceed 5000 aircraft. An industry of this scale will require an increasingly capable and sophisticated home-grown aviation eco-system, spanning aircraft maintenance, aerospace manufacturing and aircraft leasing amongst others, in the same way that China has pursued development in these areas.

In anticipation of the long-term requirements of the country's aviation industry, the Government of India is rightly exploring measures to enable the development of aircraft lessors resident in India. In this report, CAPA outlines its perspective on the prospects for this initiative.

CAPA Aircraft Advisory

CAPA Aircraft Advisory provides a flexible range of services for our clients, including:

- Aircraft economic performance studies and financial modelling;
- Asset management and risk monitoring for banks and lessors;
- Introductions to providers of competitive financing and re-financing;
- Mission requirements analysis to evaluate suitable aircraft equipment;
- OEM and lessor liaison and negotiation support;
- Structuring of terms and conditions in line with global benchmarks;
- Wet leasing placement support and opportunity identification.

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Global aircraft leasing companies are concentrated in a handful of jurisdictions – and for good reason

The leading global centres for aircraft leasing and trading include amongst others Ireland, Singapore, the US, Hong Kong and Japan. Ireland leads by a significant margin, supported by a comprehensive portfolio of Double Taxation (Avoidance) Agreements (DTAs) that minimise the exposure of aircraft leases to the purview of local taxation regimes.

This reduces costs for both lessees and lessors. Furthermore, to encourage such activity and the benefits they deliver to the local economy, several of these jurisdictions levy very competitive corporate tax rates on aircraft lessors. However, given the scale and value of such activity, even at concessional rates this brings in millions of dollars of tax revenue and supports thousands of jobs in the domestic economy.

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Example how of Double Taxation Agreements benefit aircraft leasing
Assumptions ▪ **Country A:** Domicile of airline operator ▪ **Country B:** Domicile of aircraft lessor – no DTA with Country A ▪ **Country C:** Domicile of aircraft lessor – DTA in place with Country A ▪ **Tax rate on leasing profits in Country A:** 30% ▪ **Tax rate on leasing profits in Country B:** 30% ▪ **Tax rate on leasing profits in Country C:** 10% ▪ **Withholding tax on rental income paid from Country A to B:** 30% ▪ **Withholding tax on rental income paid from Country A to C:** 5% ▪ **Gross lease rental:** USD400,000 per month or USD4.8 million per annum **Scenario 1, Airline leases aircraft from lessor in Country B:** In the absence of a DTA, the airline would be required to withhold USD1.44 mn from the payment to the lessor. The lessor would receive only USD3.36 mn. And profits on this transaction will further be taxed at 30% by Country B. **Scenario 2, Airline leasing aircraft from lessor in Country C:** In the case of a favourable DTA with a global aircraft leasing centre, the withholding amount on lease rentals is likely to be 5%, or in some cases 0%. The lessor would receive USD4.56 mn rather than USD3.36 mn. And to support the growth of global leasing activity, the tax authorities in Country C may apply a lower tax rate on the profits generated by the sector e.g. 10%. To account for this difference, a lessor based in Country B would have to charge a higher lease rental to achieve the same returns.

In addition to a dedicated tax regime, a successful leasing centre needs an enabling eco-system of institutional and professional services

A successful leasing industry is dependent upon the availability of highly-skilled professionals, with experience across areas such as aircraft marketing, compliance and risk monitoring, re-delivery, technical oversight, capital raising, treasury functions, strategic planning, and tax and legal advisory.

Despite the high labour and operating costs in leasing centres such as Dublin and Singapore, the scalability of the business and the low rates of taxation deliver high returns for equity providers.

Availability of diversified sources of capital with deep pools of liquidity is critical for a successful industry

Capital markets contribute close to 40% of global aircraft financing for new deliveries. Key providers of equity for aviation capital/leasing activities are typically private equity and hedge funds, pension funds, family offices, insurance companies and other institutional investors. Some lessors are listed, however smaller and retail investors account for a relatively small proportion of equity capital.

The providers of debt are typically a few dozen banks and institutional investors with a mandate or appetite for fixed-income investments backed by aircraft. Capital markets enable lessors to raise significant amounts of debt by issuing fixed-income instruments such as bonds, to which institutional investors, and in some cases, non-institutional investors, can subscribe.

In developing the ability to efficiently place and sell aircraft, aircraft lessors have contributed immensely to realising value in aircraft ownership. At the risk of over simplification, banks were earlier hesitant to take aircraft as collateral for loans to operators, given the uncertainty with respect to price discovery in the event of having to dispose of an aircraft.

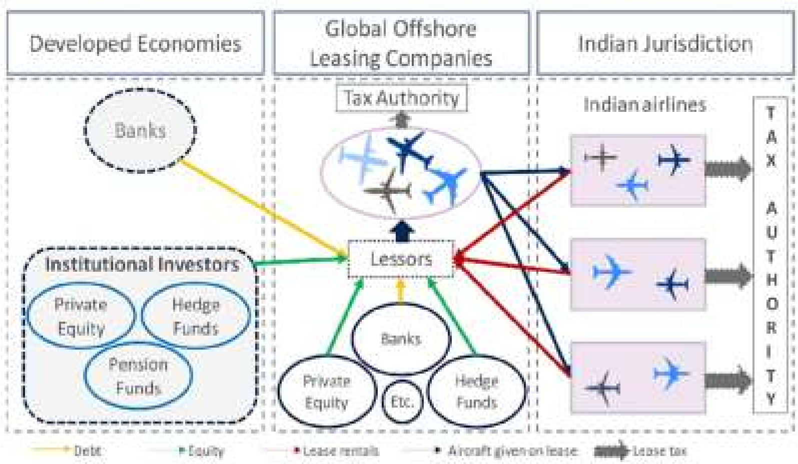
Lessors have provided greater depth to aircraft markets and increased confidence in valuations. Unlike airlines, which typically acquire aircraft only when required for operations or when they have the financial means, lessors are continuously seeking attractive deals, providing ongoing price discovery. This provides investors and creditors with greater comfort when financing aircraft for operators and lessors alike.

With their sophisticated management systems, techno-commercial and legal expertise, aircraft lessors have delivered stable yields and dividends to their creditors and shareholders respectively, attracting increasing amounts of capital to the sector.

Aviation capital is largely denominated in USD and EUR

Most capital flows into aircraft leasing are from entities that have rate of return expectations in USD, GBP, EUR and JPY, ranging from low single digits to the low teens depending on the nature of capital – debt, mezzanine or equity.

Exhibit 1: Debt, equity and lease rental flows for aircraft leasing



Source: CAPA India research and analysis

Indian providers of capital have limited awareness of aircraft as a yield-generating asset class.

Capital denominated in Indian Rupees (INR) does not participate in the aircraft leasing market for two key reasons:

1. The elevated return expectations of INR debt and equity capital providers, given India's higher interest and inflation rates relative to developed economies;
2. Limited awareness of aircraft as a yield-generating class. Indian investors have traditionally seen airlines as the primary vehicle for gaining exposure to the growth in the aviation sector and many have had a negative experience in this area.

As of today, there is little to attract global lessors to establish residence in India.

From a foreign lessor's perspective, India is not currently an attractive location to base leasing activities. Even if fiscal benefits were available as a result of locating in a tax-friendly Special Economic Zone (SEZ), key challenges would remain due to the fact that the present structure of India's DTAs would render proposals from an Indian-resident leasing company uncompetitive.

In addition, the absence of a local talent pool would require the leasing company to be staffed by expatriates. To attract the requisite talent would increase costs, especially as India is viewed as a relatively less desirable residence for global executives.

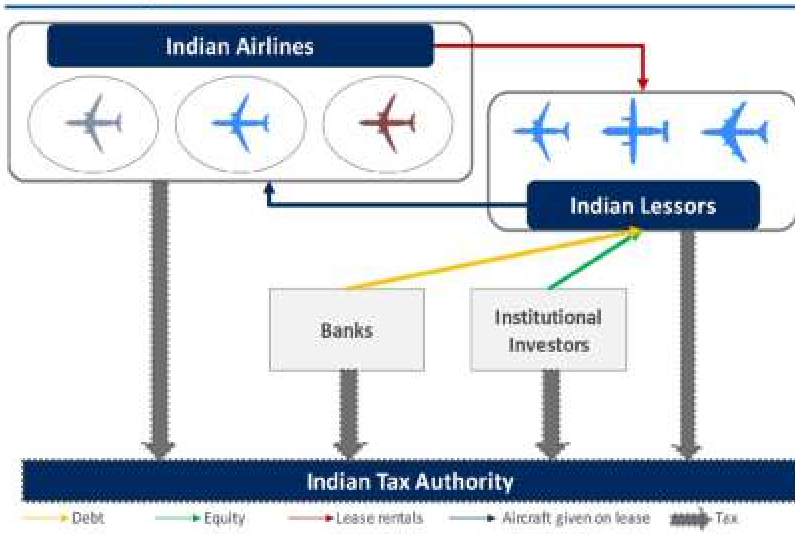
A further challenge results from the fact that foreign investors and creditors would be taking exposure to INR exchange risks. At the time of capitalisation of the leasing entity funds will be converted from USD to INR. This will be reversed in order to acquire aircraft. Lease income in USD will be converted to INR, but again reversed to pay dividends and service debt. Multiple conversions will increase risks and reduce margins. The situation is further complicated by India's only partially liberal capital convertibility regime.

To overcome some of these challenges, an Indian leasing industry would need to raise domestic debt and equity, but this alone will not be sufficient

To establish leasing activity that is able to offer Indian airlines competitive lease rates, is insulated from currency movements, and which also generate tax revenues and stimulates economic activity, will not only require lessors to domicile in India, but will necessitate that domestic providers of capital (and not just banks) come forward.

The prospects for an Indian-resident lessor will improve if the entity has Indian shareholders and creditors. However, the challenge with this is that to meet the return expectations of local capital providers, the lease rates that would need to be offered would not be competitive.

Exhibit 2: Proposed scenario



Source: CAPA India research and analysis

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For example, assuming that the implicit interest cost of leasing a brand-new single aisle aircraft worth USD45 mn for 10 years is approximately 5.0% for the lessee, this would be equivalent to about USD361,000 in monthly lease rentals.

From the lessor's perspective, we have assumed the following for financing of the aircraft:

- USD7 mn of equity capital;
- USD38 mn comprising loan facilities from two banks:
    - USD30 mn senior loan on an 8-year term;
    - USD8 mn junior loan on a 10-year term.
- Furthermore, the lessor has obtained a USD17.6 mn residual value guarantee;
- Both the weighted average cost of debt of about 3.9% pre-tax yield for creditors (with an 8.5 year weighted average term; or the 6.3% pre-tax yield for equity providers, would be too low for INR denominated lenders and investors respectively.

Baseline (pre-tax) return expectations for INR capital would be above 8.3% for debt (8.5-year term) and 19.8% for equity. These are high-level estimates, based on the Sep-2018 zero coupon yield curve of fixed income securities issued by the Government of India, and the long-term total returns on the equity index representing India's leading financial services firms.

For a more accurate assessment, a spread must be added to the zero-coupon yield to account for risk (relative to nearly zero credit risk in government securities) in realising value upon the sale of the encumbered aircraft.

For equity, a more accurate rate would require an estimation of the beta of the aircraft leasing business in India. For the India-specific beta, the beta of lessors listed in the US, UK and Hong Kong can be referenced, unlevered, adjusted for economic differences and re-levered to the India context.

For this analysis, the cost of borrowing from Indian banks can reasonably be assumed to be 12% for the 8.5-year term loan, with the aircraft as collateral. Leasing of assets (other than aircraft) is not prevalent in India, and hence the cost of debt for financing assets owned by lessors and which would be leased to asset operators is an estimate.

The lease rental with debt costing 12% and equity costing 19.8% would be USD626,000/month. A Dublin-based lessor could offer to lease the same aircraft type at a far more competitive USD361,000/month.

Given that India does not have suitable bilateral international agreements on taxation, the India-based lessor could focus only on opportunities in India. But as demonstrated above, it would not be able to offer competitive pricing even to Indian airlines.

Recent CAPA Aircraft Advisory Experience

- **South Asian flag carrier:** We were appointed by the airline's aircraft acquisition committee to review aircraft and engine OEM proposals and to evaluate the aircraft in line with the carrier's business and strategic plan.
- **Start-up LCCs and Regional Airlines:** CAPA has led negotiations on behalf of multiple start-up carriers, with aircraft manufacturers, including Airbus, ATR, Boeing, Bombardier and Embraer with respect to acquisition or leasing.
- **Very Light Jet business:** CAPA was engaged by a private equity fund to conduct due diligence on a charter business model based on the induction of a new Very Light Jet (VLJ) aircraft type.
- **Business Jet Acquisition:** Two leading business houses appointed CAPA to advise on the proposed acquisition of a pre-owned business jets based on mission requirements and performance analysis.

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A dedicated and competitive tax regime for lessors, which offers long-term fiscal certainty is the first step

To enable Indian-resident lessors to offer competitive proposals to airline operators, whilst delivering attractive returns to capital providers, the Government of India would need to implement several tax reforms, as proposed below:

1. Rental income earned from the leasing of aircraft should be exempt from all taxes and levies, including income tax, GST, capital gains tax, stamp duty and import duties (on aircraft);

2. Key input costs should be exempt from taxes e.g. banks earning interest on debt provided to lessors;

3. Equity investors should be eligible for full depreciation of aircraft assets over 8 years. Japan is a major provider of aviation capital, as its tax laws allow investors in Special Purpose Corporations (SPCs) to claim accelerated depreciation benefits on assets (in this case aircraft). Investors need not have the expertise to manage aircraft investments, as professionals such as lessors are appointed to oversee the management and administration of the SPC and its assets.

The proposed structure outlined above relates to operating leases and may not be applicable for finance leasing structures. However, most leased aircraft globally are on operating leases.

For the Indian government there is little to lose since it generates minimal tax income from leasing activities due to the DTAs in place between India and global leasing centres. Instead, it represents an opportunity to encourage the development of new economic and employment generating activities for the country.

In India, the corporate tax rate is approximately 33%. The post-tax return expectations of INR institutional debt and equity providers are 8.0% and 12.7% respectively, assuming that equity capital is retained by the lessor (no dividends and buybacks) and that the cost of issuing fixed income securities with movable assets as collateral are not significant. Such fixed income securities may be subscribed to by Indian corporations with business interests in areas other than aviation.

Alternatively, debt may be provided by Indian banks and non-bank financial companies (NBFCs), in which case the return expectations may be different from 8.0% due to differences in the applicable taxation treatment of such institutions.

When the proposed tax incentives are applied to the earlier example, this brings the equity return to 12.7%, while maintaining a lease pricing/lease rate factor at 5.1%. This is achieved with a debt return of 8.0%. The lease rental is brought down from USD626,000 to USD363,000. The cost of the lease is still marginally higher for the lessee, at 5.1% from India vis-à-vis 5.0% from a global leasing centre and lease rental of USD363,000 vis-à-vis USD361,000. However, there is no exposure to currency risk.

The depreciation benefit required to achieve the net equity return of 12.7% is significant – full depreciation of asset acquisition cost over an 8-year term. It should be noted that this benefit is to be offered to the shareholders of the lessor, not the lessor itself. Such shareholders could be highly profitable business enterprises (which may not have any interests or expertise in aviation) seeking to minimise their tax liability by owning shares in Indian aircraft leasing companies with competent, relatively independent management teams which have a board for fiduciary governance. Management teams could generate abundant capital from cash rich investors, to acquire aircraft meant for the Indian air transport market.

Table 1: Deal economics and returns on invested capital

Prevalent and from leasing centre	Parameters	Proposed in India	
		Before incentives	After incentives
$361,000 (5.0% for 10 year period)	Cost of lease for airline lessee	$626,000 (5.0% for 10 year period)	$363,000 (5.1% for 10 year period)
6.3% (pre-tax)	Return on equity provided to Indian lessors	19.8% (pre-tax)	12.7% (=19.8% pre-tax)
3.9% (pre-tax, 8.5 years weighted average term)	Cost of debt provided to Indian lessors	12.0% (pre-tax, 8.5 years weighted average term)	8.0% (8.5 years weighted average term, =12% pre-tax)

Source: CAPA India research and analysis

It is important to consider that under most market conditions, aircraft debt - backed with the aircraft as collateral - is a much better credit risk than most exposure taken by Indian financial institutions. This is due to the robust international market for aircraft.

However, comfort in aircraft as collateral is contingent on the availability and application of expertise and relationships in appraising, marketing and selling aircraft. These are almost non-existent in India at present and would require the support of expensive foreign executives.

Leasing specialists from overseas would be required to establish and support the growth of the Indian aircraft leasing industry until such time as local talent has been groomed to take the sector forward. Aside from management and aircraft marketing, the knowledge pool on legal and taxation aspects of aircraft leasing is also quite limited in India.

An Indian aircraft leasing sector is an idea worth exploring. But key strategic issues will need to be addressed.

Developing a viable Indian aircraft leasing industry will be a long-term undertaking. However, given the growth outlook for the sector it is an initiative that deserves consideration. The government's initiation of consultation amongst key stakeholders to explore options is very encouraging. Some of the key issues to be considered include:

- Will Indian airlines find it beneficial to lease equipment from an Indian lessor? Sale-and-leaseback is the preferred structure, but it is possible that Indian carriers may not be comfortable with the level of disclosure required to execute such transactions in India. Airlines may be wary about the prospect of increased regulatory attention in India in the absence of clarity around the applicable framework.
- How will expertise be inducted? There may be limited incentive for a global lessor to partner with an Indian company to establish an Indian-resident business, given that they can adequately serve Indian airline operators from offshore.
- How can the necessary legal and tax advisory skills be developed in-country?
- What will the aircraft portfolio look like? New generation narrow bodies are the obvious choice given demand in the Indian market and the liquidity of the type globally. Could Indian lessors support regional connectivity by offering regional jets, turboprops and commuter equipment, which some of the larger global lessors do not support?
- Would a lessor be comfortable with the market risk of being able to serve Indian airlines alone? It will not be able to make competitive offers to foreign airlines, at least until such time as India renegotiates its DTAs. Should there be a downturn in the Indian market, equipment would either need to be sold, or remarketed offshore with much lower returns due to the additional tax burden.
- Is it possible that Indian airlines with large order books could choose to establish their own leasing arms? CAPA research indicates that one carrier may set up a global leasing and management division offshore, but another may be open to consider a local leasing arm subject to the right conditions.
- Does India have a sufficient pool of liquidity to support the sector? Relying on banks alone will not provide long-term depth.
- Will Indian banks be willing to take exposure to aircraft assets given their limited understanding of values and trading? There may not be an appetite to take on this risk,

especially in light of record levels of non-performing assets, and in the aftermath of some high profile bank credit and governance scandals.

- Is there sufficient confidence in the regulatory provisions that govern repossession of aircraft in the event of default? India has not fully implemented the Cape Town Convention. As a result, the experience of banks and lessors in repossessing equipment from distressed airlines and general aviation operators in India has been less than ideal. Deregistration can take weeks or months, and it is not always straightforward to obtain recognition of the lessor's first claim on an aircraft.
- Would leasing companies need to be located in an SEZ to avail of tax benefits? If these are located in non-metro locations it may be more difficult to attract skilled resources. Air connectivity is also important as leasing executives travel frequently to meet with airline customers and other stakeholders.

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Government of India
Ministry of Civil Aviation
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Rajiv Gandhi Bhavan, Safdarjung Airport
New Delhi - 110003
er-sec.moca@nic.in