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## Aviation in Malta

Photo by Keith Buhagiar

Over recent years, Malta has witnessed growth in the aviation industry, attracting a number of international entities to set up operations in Malta. In turn the Maltese authorities support this industry, with the aim of becoming a centre of excellence in the aviation industry.

The Malta flag's attractiveness has already proven itself in the maritime industry, where the Maltese shipping register is the second largest in Europe and the eighth largest in the world. Recent initiatives to boost aircraft registration are indicative of the country's willingness for the aircraft register to follow in the footsteps of the shipping register.

### Advantages of the new legislation

During 2010, a new Aircraft Registration Act was enacted which consolidated the existing laws on registration and incorporated novel concepts, focusing not only on enhancing aircraft registration, but also other sectors of the aviation industry.

#### ➤ Broader registration possibilities

A key innovation in the new legislative framework is the widening of possibilities and eligibility criteria for the registration of an aircraft.

Applicants who may register aircraft include owners of aircrafts under construction, operators of aircraft under temporary title, such as a lease, and buyers under a conditional sale or title reservation agreement. This allows purchasers and operators to address financing and ownership issues in a legally certain manner prior to delivery.

It is now also possible to register aircraft engines, thus rendering scope for engine financing opportunities.

Registrants of private aircraft are not subject to the qualifying requirements of aircraft used for 'air services', which need to obtain a Maltese operating licence. If the aircraft is not used for air services, it may be registered by any aviation undertaking established in an OECD member state.

#### ➤ Concept of fractional ownership

Fractional ownership of aircraft is a relatively new concept. It represents a part share in an aircraft that entitles the holder to use the aircraft for a designated amount of time over a specified period.

#### ➤ Use of trusts

In addition to fractional ownership, the Act allows for the registration of an aircraft under the terms of a trust. When the registrant is a trustee, the authorities will consider the beneficiaries of the trust to determine the eligibility of the trustee for aircraft registration. The information obtained will be subject to confidentiality.

#### ➤ Lower borrowing costs

The ratification of the Cape Town Convention, enables lessees to benefit from lower borrowing costs, besides providing lessors with preferential ranking (through the registration of an international interest ranking prior to national security interests) and self help repossession remedies in cases of default.

#### ➤ Registration of mortgages

It is common for an aircraft to act as a security for a debt or other obligation. The Aircraft Registration Act provides that all registered mortgages, to which a Maltese registered aircraft may be subject, are not affected by the bankruptcy or insolvency of its mortgagor/owner occurring after the date on which the mortgage was created.

Furthermore, there is enhanced protection for mortgagees who are empowered to perform the following:

- (i) Prohibit the creation of further mortgages on the aircraft, or the transfer of the aircraft, without the mortgagee's prior written consent, subject to this requirement being stated in the mortgage instrument.
- (ii) Appeal to the Administrative Review Tribunal where the registration has been cancelled for unjustified reasons, or notwithstanding that effective action has been taken to remedy the complaint, the Director General has failed to withdraw the order to cancel.
- (iii) In case of default, the mortgagee can (i) lease the aircraft and receive the lease income; (ii) receive any payment of the price, lease payments and any other income generated from the management of the aircraft; (iii) take possession of the aircraft; or (iv) sell the aircraft.

#### ➤ Accession to the Cape Town Convention

The provisions of the Cape Town Convention have been implemented in the new Act. Malta's ratification of the Convention allows persons involved in cross border secured financing and aviation leasing transactions to benefit from increased predictability and certainty of rights and remedies.

This is triggered by the registration of international interests in the International Registry, which creates priority ranking of security interests. An aircraft lessor under a leasing agreement, a conditional seller under a title reservation agreement or a charger under a security agreement, may now register an international interest in an airframe, engine or helicopter in the International Registry. Subject to special privileges, the general rule is that an international interest ranks prior to national security interests.

As a result of the advantage of mitigating financial risk, interest rates charged are typically lower, resulting in reduced financing and leasing costs borne by purchasers or operators of aircraft in Malta.

### ➤ Eligible persons to register aircrafts in Malta

The following are persons who are eligible to register **commercial aircrafts** in Malta:

- (i) The Government of Malta
- (ii) A citizen of Malta or a citizen of any one of the member states in the EU, of an EEA state or Switzerland. Such individuals must have a place of residence or business in the above-mentioned locations.
- (iii) A company or other undertaking formed and existing in accordance with the Laws of Malta, a member state of the EU, the EEA or Switzerland. Such undertaking must also have its registered office, central administration and principal place of business within these jurisdictions. Not less than 50% of the undertaking must be directly or indirectly owned by the above-mentioned parties.

All operators or aircraft engaged in commercial air transport activity are required to be in possession of Air Operator Certificate (AOC) and Operating License.

The following are persons who are eligible to register **private aircrafts** in Malta:

- (i) The Government of Malta
- (ii) A citizen of Malta or a citizen of any one of the member states in the EU, of an EEA state or Switzerland. Such individuals must have a place of residence or business in the above-mentioned locations.
- (iii) A company or other undertaking formed and existing in accordance with the Laws of Malta, a member state of the EU, the EEA or Switzerland. Such undertaking must also have its registered office, central administration and principal place of business within these jurisdictions. Not less than 50% of the undertaking must be directly or indirectly owned by the above-mentioned parties.
- (iv) A natural person who is a citizen of, or an undertaking established in a member country of the OECD and any country approved by Malta, provided such person
  - a. Has the legal capacity to own/operate an aircraft in terms of law;
  - b. Appoints a legal resident agent to represent the owner in Malta for matters concerning the registration of the aircraft; and
  - c. Complies with the applicable regulations and guidelines.

An international registrant must appoint a resident agent who is habitually resident in Malta, which agent is to be present at all times.

The registered agent shall on behalf of the international registrant:

- (a) Act as the channel of communication between the international registrant and the Director General;
- (b) Sign and file with the Director General all declarations and forms as required under Maltese law;
- (c) Act as the representative of the international registrant for judicial proceedings in Malta.

## Fiscal regime

### ➤ In General

Parliament has recently enacted legislation that introduced a number of fiscal incentives in relation to international aviation, being of particular interest and benefit to aircraft engine and aircraft operators. These are expected to render Malta a more attractive jurisdiction from where to conduct such operations. Such amendments are targeted to complement the Aircraft Registration Act.

Malta has opted not to provide an outright exemption to income derived from aviation. The general Maltese tax regime i.e. the imputation system of tax, the standard corporate rate of tax, double taxation relief and the refundable tax credit system amongst others apply also to aircraft operators. The aircraft itself is recognized as the income earning asset as opposed to having income derived from an income earning activity in Malta.

### ➤ Income derived from the ownership, leasing or operation of an aircraft or aircraft engine.

A fundamental provision has been introduced in Malta's tax legislation, so that income derived from the ownership, leasing or operation of aircraft or aircraft engines engaged in the international transport of passengers or goods is deemed to arise outside Malta for Maltese income tax purposes. Such income is deemed to arise outside Malta irrespective of:

- The country of registration of the aircraft/engines; and
- Whether the aircraft calls at or operates from Malta.

Under Malta's remittance basis of taxation, income deemed to arise outside Malta will be exempt from Maltese tax if this income is not remitted to Malta. Consequently, a highly viable option is presented allowing for the shifting of tax residence of a foreign aircraft company to Malta in order to benefit from the deemed source provision. This rule, combined with the rules on the operation of aircraft in international traffic contained in Malta's double taxation agreements, presents attractive tax planning opportunities for airline and aviation operators setting up their residence in Malta.

Companies which are resident and domiciled in Malta are subject to income tax in Malta on their world wide profits. However companies which are registered in a foreign jurisdiction and thus not domiciled in Malta, that shift their tax residence to Malta will be subject to tax in Malta on income and capital gains arising in Malta and on foreign income which is remitted to Malta. This means that income derived from the operation, leasing or ownership of an aircraft will not be subject to income tax in Malta unless such income is remitted to Malta. Such income is not deemed to arise in Malta and hence not taxable in Malta.

In a tax treaty context, profits derived from the operation of an aircraft in international traffic are taxable only in the Contracting State in which the place of effective management of the enterprise is situated. Thus if the effective management of the company is situated in Malta, such profits are in terms of the pertinent tax treaty only subject to tax in Malta, which in any case would be exempt from tax unless received in Malta.

This rule provides some interesting tax planning opportunities:

- a) It ensures that the leasing of aircraft/aircraft engines by non residents to Maltese resident lessees is not subject to Maltese income tax, whether by withholding or otherwise. This applies irrespective of the existence or otherwise of a double taxation treaty between Malta and the country of residence of the lessor.
- b) It opens up to Maltese resident aircraft lessors/operators planning opportunities under Maltese income tax law in respect of foreign source income, while enabling them to make use of Malta's double taxation treaty network where applicable.

Companies which are neither resident nor domiciled in Malta are subject to tax in Malta on income and capital gains arising in Malta. Since income derived from the ownership, leasing or operation of the aircraft is deemed to arise outside Malta, such income is not subject to income tax in Malta even if such income is received from a Maltese person. Such income would fall outside the scope of Malta tax.

Aircrafts used for private purposes should not generate any income and therefore there should be no Maltese tax implications. Payments made to a **Maltese vendor** for the alienation of an aircraft, should only be taxable in Malta if such vendor is carrying on a trading activity. In the case of payments made to a **foreign vendor** for the alienation of an aircraft, such payments should only be taxable in Malta if such vendor is carrying on a trading activity in Malta and is in the business of selling aircrafts.

### ➤ Tax refund on distributed profits

Aircraft leasing and other profits derived by companies which are resident and domiciled in Malta, i.e. subject to tax on their world wide income is taxable at the standard corporate rate of tax in Malta which currently stands at 35%.

However, on distribution of such profits, the imputation system applies with qualifying shareholders being entitled to a refund of tax of 6/7ths calculated on the tax suffered by the company on such distributed profits, resulting in a net paid in Malta of 5%.

#### ➤ Depreciation of an Aircraft

The Deduction for Wear and Tear of Plant and Machinery (Amendment) Rules, 2010 provide for new depreciation periods for wear and tear of aircraft or aircraft equipment. These have been decreased rendering Malta increasingly competitive.

The amendments change the minimum period of wear and tear of an aircraft for income tax purposes. Prior to such changes, the minimum period for aircraft depreciation was 12 years. With the coming into force of these amendments, depreciation of aircraft and its constituent parts will range over a minimum number of years as follows:

- Aircraft airframe - 6 years;
- Engine - 6 years;
- Engine or aircraft overhaul - 6 years; and
- Interiors and other parts - 4 years.

The minimum periods are effective retrospectively as from 1 January 2009.

Accelerated depreciation allows larger portions of the depreciation value to be claimed early in the depreciation cycle, resulting in larger deductions for a shorter depreciation period. Accelerated depreciation can reduce costs during a company's start up years. The increased deductions which are created by accelerated depreciation allow companies to defer a portion of their tax liability.

#### ➤ Exemption from Fringe Benefits

Law Notice Number 292 of 2010, Fringe Benefits (Amendment) Rules 2010, creates a new exemption from fringe benefits rules. This applies to an employee or officer of an employer as well as companies or partnerships, whose business activities include the ownership, leasing, or operation of any one or more aircraft or aircraft engine which is used for or employed in the international transport of passengers or goods. Moreover such persons ought to be non-Maltese residents.

#### ➤ Taxation on Aircraft Leasing

The Maltese Tax Authorities have published guidelines on the tax treatment of finance leasing of aircraft. The guidelines pertain to aircraft finance leasing arrangements not exceeding four years. Arrangements of four years or more are governed by different rules.

The new guidelines clarify the position pertinent to the level of taxable income in the hands of the lessor and the type of deductions that the lessee is entitled to claim.

The following tax treatment is to be adopted for each year of the duration of the finance lease.

In the case of a **finance lease**, the **lessor** is charged to tax on the annual finance charge, namely the difference between the total lease payments less the capital element divided by the number of years of the lease. On the other hand, the **lessee** is allowed a deduction in respect of finance charge, maintenance, repairs, and insurance.

The **lessee** is also allowed capital allowances in respect of the aircraft and the parties may not opt to shift the burden of wear and tear onto the **lessor**. Where the **lessee** exercises an option to purchase the aircraft on the termination of the finance lease, and the **lessor** is not trading in the purchase and sale of aircrafts, the purchase price received by the **lessor** shall be considered to be of a capital nature and no tax thereon will be payable by the **lessor**.

In the case of an **operating lease**, the **lessor** is taxable on the full amount of the lease income and if it maintains the burden of wear and tear, it will be able to claim capital allowances in respect of the aircraft.

The **lessee** on the other hand, is entitled to deduct the full amount of the lease payments and to claim capital allowances on the aircraft if it maintains the burden of wear and tear.

The new guidelines are mainly pertinent to lessors and/or lessees that operate from Malta using a Maltese-registered limited-liability company. A Maltese company is subject to tax in Malta on its worldwide income. On the other hand, the international aviation income derived by a lessor/lessee that is resident, but not registered, in Malta is deemed to arise outside Malta. Accordingly such income will be taxable in Malta solely on a remittance basis.

#### ➤ Investment Tax Credits

Companies that carry on a trade or business consisting of the repair, overhaul or maintenance of aircraft, engines or equipment incorporated or used in such aircraft may benefit from investment tax credits. Such investment tax credits are in line with the EU framework of Regional Aid.

Such tax credits are calculated either as a percentage of qualifying expenditure or wage costs for jobs which are directly created by the project. The investment tax credits are credited against the tax due in Malta.

The percentage of qualifying expenditure or wage costs depends on the size of the undertaking. In the case of a small undertaking, the percentage is 50%, in the case of a medium undertaking, the percentage is 40% while in the case of a large undertaking, the percentage is 30%. Unutilised investment tax credits may be carried forward against the tax due in subsequent years.

### Value-Added Tax Treatment of Aircraft Leasing

#### ➤ In General

The Maltese Value-Added Tax (VAT) Department has launched a new aircraft leasing procedure, making Malta an attractive jurisdiction for aircraft registration for both private and commercial aircraft while ensuring full adherence to EU laws and regulations. The new regulations provide that the payment of VAT is exclusively due on the amount of time spent by the aircraft within EU airspace.

Malta VAT implications vary according to the manner in which the aircraft is used, that is, whether the aircraft is employed by an airline operator for reward chiefly for international transport of goods or passengers, or whether it is purely for private use. VAT implications similar to those applicable in other EU member states would be applicable in respect of importations, intra-community acquisitions, or supply of aircraft.

The intra-community acquisition, importation or supply of aircrafts destined for use by an airline operator for reward chiefly for international transport of passengers or goods is an exempt with credit supply.

The following are also exempt without credit supplies.

- (a) Supplies of equipment to constructors, owners or operators of the aircraft;
- (b) Supplies of services consisting of the modification, maintenance, chartering and hiring of the aircraft.

The new VAT treatment applies to all aircraft other than those used by airline operators in international traffic since a VAT exemption applies in the latter case. In accordance with Malta's VAT legislation, the lease of an aircraft, which is not used by airline operators in international traffic, is a supply of a service which is subject to VAT with the right of deduction of input VAT by the lessor. In terms of the VAT simplification procedure, the portion of the lease that will be subject to VAT will depend on the amount of time that the aircraft is used in EU airspace.

Since it is difficult to identify the movement of an aircraft in advance and the period in which the aircraft is used in EU airspace, Malta will apply an expert technical test to estimate the portion of the lease that will be subject to VAT. The calculation of the chargeable proportion of the lease is dependent on the range of the aircraft. The standard Malta VAT rate of 18 per cent will be applicable on the established percentage of the lease that will be deemed to be related to the use of the aircraft in EU airspace.

Aircraft Type by Range (KM)	% of Lease Taking Place in the EU	Computation of VAT
0 – 2,999	60%	60% of consideration x 18%
3,000 – 4,999	50%	50% of consideration x 18%
5,000 – 6,999	40%	40% of consideration x 18%
7,000 – upwards	30%	30% of consideration x 18%

#### ➤ Conditions for Eligibility

The above VAT treatment can be availed of if the following conditions are met:

- A leasing agreement is entered into between the lessor and the lessee who must both be established in Malta. The lessee may not be eligible to claim input tax in respect of the lease. The leasing agreement is an agreement whereby the owner of the aircraft (the 'lessor') contracts the use of the aircraft to another person (the 'lessee') for a consideration where at the end of the lease period the latter may opt to purchase the said aircraft at a percentage of the original cost;
- The lease agreement may not exceed a period of 60 months;
- The lease installments must be paid monthly.

A VAT-paid certificate will be issued if after the end of the lease, the lessee exercises the option to buy the aircraft, and for which prior approval must be sought in writing from the VAT Department. The VAT Department may require the lessor to submit details regarding the use of the aircraft and may impose further conditions, as it may deem appropriate in the circumstances.

#### Tax incentives for individuals working in the aviation industry

By virtue of Legal Notice 306 of 2012, the application of the Highly Qualified Persons Rules has now been extended from the financial services and gaming industries to also include the aviation industry. Certain senior positions within the aviation industry are now also considered as eligible offices, including the posts of Chief Executive Officer, Chief Financial officer, Chief Operations Officer and Chief Commercial Officer Aviation Accountable Manager, Aviation Continuing Airworthiness Inspector, Aviation Flight Operations Inspector and Aviation Training Manager.

Thus holders of such offices with qualifying aviation undertakings will be eligible for the 15% reduced rate of tax on their employment income. Benefits are available for a period of five consecutive years for EEA and Swiss nationals and for a period of four consecutive years for third country nationals.

In order to qualify for the reduced rate of tax, the individual must be employed with an undertaking holding an air operators' certificate issued by Transport Malta. Individuals who were employed with a company holding an air operators' certificate prior to 1st January 2012 cannot benefit from the reduced rate of tax.

Minimum annual emoluments from such eligible offices (excluding fringe benefits) are of €75,000. The individual must have the necessary professional qualifications and cannot be domiciled in Malta. Income amounting to more than €5,000,000 p.a. and derived from a qualifying contract of employment will not be subject to tax in Malta on the amount exceeding €5,000,000.

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