

## ABOLITION OF PRC IMPORT VAT ON LEASED AIRCRAFT

China has abolished import<sup>1</sup> value-added tax ("**VAT**") on aircraft "imports by way of leasing"<sup>2</sup> with effect from 1 June 2018<sup>3</sup>. This is a positive development for aviation lessors and financiers entering transactions with operators which involve a lease of the subject aircraft into the PRC as the costs for the lessee have been reduced. For existing leases where the aircraft were delivered prior to 1 June, there is a possibility that import VAT instalments going forward may no longer be payable, but this remains to be clarified.

### Key issues

- History and Background
- Considerations

### HISTORY AND BACKGROUND

Under the previous PRC VAT regime, cross-border aircraft leases between non-PRC lessors and PRC airlines were subject to two separate categories of PRC VAT: (i) import VAT on the import of the aircraft into the PRC and (ii) general VAT on the aircraft lease supply.

PRC airlines importing aircraft by way of leasing have been required to pay both customs duty and import VAT, in each case calculated according to the rentals payable under the relevant lease<sup>4</sup>.

The import VAT rate was significant and was in the range of 5% to 16% of the lease rentals, depending on the weight of the aircraft, and payable by the airline as the importing entity.

### General VAT

<sup>1</sup> Pursuant to the Customs Law revised by Standing Committee of the National People's Congress in November 2017, "import" means to physically bring goods into the PRC across the PRC customs border.

<sup>2</sup> "Imports by way of leasing" is a literal English translation of the Chinese term *zulin jinkou* (租赁进口) adopted under the PRC customs and tax regulatory regimes which means "an import arising from a leasing transaction". Broadly speaking, aircraft leased to PRC operators under cross-border leases fall within this term. Other leasing transactions may also give rise to such imports. For example, the term would capture an aircraft imported under a domestic lease between a PRC lessor in a PRC bonded area and a PRC airline outside the bonded area.

<sup>3</sup> On 11 May 2018, the State Administration of Taxation ("**SAT**") and the General Administration of Customs ("**GAC**") issued the Circular on Issues Related to VAT on Aircraft Imports by Way of Leasing ("**Circular 24**") providing that, with effect from 1 June 2018, the PRC customs authorities will no longer collect import VAT on aircraft imported into the PRC by way of leasing.

<sup>4</sup> Pursuant to the Tariffs Regulations revised by the State Council and promulgated in March 2017 and the Administrative Measures for the Collection of Taxes on Imports and Exports revised by GAC in May 2018.

Pursuant to separate measures<sup>5</sup>, cross-border aircraft leases with PRC lessees are VAT taxable and this has not changed under the latest announcement.

General VAT for aircraft leasing is charged at 16% of the rentals payable under the relevant lease by the relevant PRC airline. While general VAT is, in theory, payable by the lessor (as the entity providing the leasing service), since non-PRC lessors are not, usually, PRC VAT payors, PRC lessee airlines are instead required to pay general VAT by way of a withholding tax.

The co-existence of import VAT and general VAT effectively resulted in a double VAT liability for cross-border aircraft leases into the PRC.

## **CONSIDERATIONS**

Circular 24 redresses the burden imposed by such double VAT liability and is a positive sign of the government's support of the aviation industry. It benefits PRC airlines and foreign lessors alike. It will also assist (although to a limited extent) in levelling the ground for non-PRC lessors competing with PRC lessors, since the elimination of import VAT means a reduced tax burden for the PRC lessees entering into cross-border leases<sup>6</sup>.

With respect to aircraft imported into China by way of leasing before 1 June 2018, where the payment of import VAT is payable by instalments, it is very likely that instalments due after 1 June 2018 will not be required. However, Circular 24 is not explicit on this issue and it remains to be clarified by GAC and SAT.

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<sup>5</sup> The Measures for the Implementation of the Pilot Scheme on Levying Value-added Tax in Substitution of Business Tax issued by the Ministry of Finance and SAT in March 2016.

<sup>6</sup> Note that non-PRC lessors are not able to claim input credit for VAT (whilst their PRC counterparts leasing from onshore are able to do so). This means that as a practical matter, a PRC lessee's tax exposure is larger if they are dealing with a non-PRC lessor, assuming other factors being the same.

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