COELUM

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COELUM Pronunciation: 'che-l&m, is Latin for airspace or sky. The Romans began questioning the rights they had in the space above the land they owned and to how high above did that right extended to. Ad coelum et ad inferos, they discussed, meaning that their right of property would extend as high up to the heavens and down to hell.

Applicability of taxes resultant from the transfer of title or the delivery of the right of use and enjoyment of an aircraft.

VAT and Customs considerations.

by Carlos Sierra.

The transfer of title of an aircraft under an aircraft sale as well as the delivery of its use and enjoyment under a lease agreement is generally perceived as a tax generating step when caution is not exercised for such purpose during the process. This article will discuss the different scenarios under which such transfer can take place and the implications associated from a tax standpoint.

In principle, we should enumerate the three aspects under which a transaction can be said to be subject to tax in Mexico , for such purpose we should state that a transaction is subject to Value Added Tax (VAT) in Mexico when it is considered to have taken place within its territory. We will leave outside of this analysis of course the income tax associated with the revenue that the transfer of title generates and/or with the revenue that is generated by the rental payments associated with the use and enjoyment of the asset, considering that income taxes are payable by the recipient thereof depending of its jurisdiction of tax residence.

For VAT purposes on the other hand, the aspects that become relevant to consider are:

1. Whether the tax residence of the parties is located in Mexico;
2. Whether the asset is located in Mexico at the time of the transfer; and
3. Whether material delivery of the asset is being conducted within Mexican territory.

As I have mentioned above, in Mexico, as is the case of most jurisdictions, a transfer of title or the transfer of the right of use of an asset will be taxed when such transaction is considered to have taken place within Mexican territory. The VAT associated with the transfer and/or with the rent payable for the use and enjoyment of an asset however depends of the three elements enumerated above and of how these interact with the transaction in each case.

I. Transfer of Title.

The general –or at least the most conservative- perception associated with this is that when the aircraft itself is located outside of the territory of Mexico at the effective time when the transfer occurs the transaction will be necessarily considered to have taken place outside of the tax jurisdiction of the Mexican authorities and thus it is not subject to Mexican VAT. This is, in principle, a correct assumption which is however being taken only in consideration of one of the three elements described above and which fails to consider other aspects that are also relevant for such purpose.

The location of the aircraft for instance, becomes irrelevant when the place of tax residency of at least one of the parties is located in Mexico, in such case the location of the aircraft outside of Mexico does not eliminate the applicability of VAT to the transaction, particularly when the seller is a tax resident of Mexico, in which case, if the aircraft is registered in Mexico, the VAT would be applicable even in cases

when the aircraft might be placed outside of the country at the time when the transfer of title takes place.[1]

On the other hand when the two parties entering into an aircraft title transfer are domiciled outside of Mexico, the transaction will be considered to have taken place outside of Mexico and VAT will not be applicable irrespectively of whether the asset shall be located in Mexico at the effective time of the transfer or not.

The general perception then, that concludes that placing the aircraft outside of Mexico in all cases for title transfer purposes is necessary, is incorrect, considering that, when the two parties are not tax residents of Mexico, the placement of the aircraft abroad becomes completely unnecessary.[2]

The material delivery of the asset is another aspect to consider given that such would be a detonator of the VAT. The transfer of title between two foreign entities, or between a foreign tax resident seller and a Mexican tax resident buyer, should not involve the material delivery of the asset within Mexican territory in order to avoid falling in to this other test of the law which considers VAT to be payable when the asset shall be materially delivered to the buyer within Mexican territory.

II. Transfer of the right of use and enjoyment.

The transfer of the right of use and enjoyment as it occurs during a lease is, under Article 21 of the VAT law, subject to VAT when the material delivery of the use and enjoyment of the asset involved is conducted within Mexican territory. The transfer of the rights of use and enjoyment under a traditional aircraft lease generally occurs between a foreign tax resident acting as lessor and a Mexican tax resident acting as lessee. In this case, the material delivery of the asset should be conducted while the asset is located outside of Mexican territory. This will eliminate the risk of VAT becoming applicable to rental payments payable by lessee to lessor under the lease.

III. Novation and Assignment.

A more interesting case is faced when the transfer of title of an aircraft between, say the lessor as owner for instance and a new buyer of the aircraft, causes the rights of the lessor under the lease to be novated or assigned in favor of such new buyer, who shall then, after becoming owner of the aircraft become the new lessor thereof. Similar scenarios can take place when the beneficiary interest of an aircraft is acquired through the transfer of the shareholder interest of the lessor to a new lessor under an assignment of the rights of the lessor under the lease, or, when a security assignment entered as a form of guaranty under the lease becomes effective following a default of the previous lessor of its financial obligations in favor of the beneficiary of such guaranty.

In cases like this we need to consider that Mexican law differentiates the effects of a novation from such of an assignment of the rights of the lessor under a lease. A novation by definition, will cause the

1.- Value Added Tax Law (Ley del Impuesto al Valor Agregado), Article 10.
2.- Value Added Tax Law (Ley del Impuesto al Valor Agregado), Article 9.

contractual relationship (i.e. the lease) between the parties to be replaced in its entirety and thus, for the previous aircraft lease to terminate and be replaced by a new lease. This in itself means that the right of possession of the asset by the lessee will terminate and thus the aircraft involved will need to be subject of a new delivery under the new novated lease. When this occurs the material delivery of the asset under the new lease becomes a feature and, if becoming effective while the aircraft is located in Mexican territory, will be regarded as the material delivery of the asset under the new novated lease that will generate the applicability of VAT to all subsequent rental payments. In such case, the aircraft should be flown outside of Mexico in order for the delivery thereof under the new novated lease to take place.

A completely different case however should be seen under an assignment of the lease, in consideration that the assignment, under Mexican law, is not a novation and does not imply the termination of the previous lease but only its modification and continuance in respect to all unmodified terms and provisions. In this case, the replacement of the lessor by a new lessor does not imply the termination of the existing lease but only its amendment. In the case of an assignment the lease continues to be effective since the time when it was first entered into between the previous lessor and lessee and the possession of the asset is considered to be continuing at the time when the substitution of the prior lessor for the new lessor is conducted. In the interpretation of an assignment no material delivery occurs of the asset upon effectiveness thereof and no VAT will be applicable to the subsequent rentals that will continue to be paid for all purposes under the original lease, except that in favor of a different party acting as the new lessor of such aircraft. Considering the above then the aircraft can remain within Mexican territory upon the assignment becoming effective.

The same is the case of an assignment of the rights of the lessor when a security assignment shall become effective, the effectiveness of the old lease shall continue and the right of possession of the aircraft in favor of the lessee will not be considered to have been interrupted at the time when such assignment shall become effective.

IV. Importation.

Another aspect to consider is the general rule that is incorrectly considered to be applicable that prohibits the transfer of title of an asset that is subject to a temporary importation regime under Article 106 of the Mexican Customs Law.

In that respect the prohibition in question is clearly stated in Article 105 of the Customs Law. This prohibition however needs to be looked at from the point of view of the subject that the Customs Law is intended to regulate which, in this case will be the party that conducted the importation and that, for such purpose, was entitled to the benefit of the temporary importation regime, to which only certain qualifying parties are entitled. In this case, a lessee that is entitled to conduct the operation of public air transportation services of passengers and cargo is entitled to the benefits of this legal regime of importation (i.e. the temporary importation for a period of up to 10 years[3], being such party also subject to conduct the exportation of the asset upon expiration of this term. For evident reasons then, when

3.- Customs Law (Ley Aduanera), Article 106, II paragraph V.

Article 105 of the Customs law intends to prohibit the transfer of title of a temporarily imported asset, it intends to prevent the loss of the described public service operator prerogative that the importer must have. In other words, if an asset that was imported under a temporary importation regime by an eligible party changes hands and becomes owned by a new Mexican entity that was not entitled to such importation regime in the first place (e.g. any other kind of non-public service operator) the exempted importation duties become due, which include VAT on the value of the imported asset and ad-valorem importation duties quantified based on the applicable tariff. The purpose then of the prohibition becomes evident: The law must prevent that the beneficiary of a temporary importation regime be any party other than the party that is originally eligible to such benefit.

The above consideration makes perfectly clear that Article 105 of the Customs Law is not intended to prohibit the transfer of title of the asset by the owner, when such owner is not the party that conducted the importation under the temporary importation regime, but a foreign resident owner of the aircraft acting only as lessor, for example, which is totally strange to the temporary importation process and to its limitations. This interpretation is obvious and, to settle any differences, has been followed by the criteria that was clarified by the Tributary Administration Service in the document named norm criteria compilation in matters of Foreign Trade and Customs,[4] where it resolves that Article 105 of the Customs Law –and the prohibition ton transfer that it contains- is only applicable to transactions that have been conducted within Mexican territory (i.e. to transactions that involve the transfer of title that is conducted by the beneficiary of the temporary importation regime.

V. Conclusions.

1. The transfer between foreign parties is not considered to have been conducted in Mexican territory and thus is not subject of VAT.

2. The material delivery of an aircraft within Mexican territory causes VAT to be applicable in all cases (e.g. the delivery of the use and enjoyment of an aircraft in Mexico or a novation of a lease).

3. The material delivery of the aircraft within the territory of Mexico is not considered to occur in all cases (e.g. transfer between foreign parties or the assignment of the rights of lessor under a lease).

4. The transfer of an aircraft when the owner is not the Mexican operator does not violate the temporary importation regime of the aircraft and is not prohibited under Mexican law while such temporary importation is effective.

5. The transfer of title of an aircraft when located in Mexico and when the lease is not novated or restated does not require the aircraft to be exported and imported again. The aircraft lease and the aircraft registration (if registered in Mexico) do not need to be discharged.

4.- Issued by the Tax Administration Service (SAT) in its 2010 Bulletinand autorized by official writ 600-05-03-2010-74021 dated June 30, 2010, criteria No. 50.

Washington Protocol: Minimum Requirements that a Power of Attorney must have to be used abroad.

by Roberto Najera.

As we are aware, many legal and commercial operations between countries have occurred over the last century. These operations could not have taken place without a simple but powerful instrument such as the Power of Attorney. Through this instrument foreign companies can be represented by local attorneys and through them, execute a variety of acts. Nevertheless the way of granting a Power of Attorney and its effectiveness varies with the local laws of every country.

To homologize and ensure that the Powers of Attorney can be effective abroad, the Inter-American Protocol on Uniformity of Powers of Attorney to be Used Abroad of the Pan-American Union (Washington Protocol) was signed between different countries of North, Central & South America[1] in 1940, this included Mexico -who ratified it in 1953- and the United States of America. In this article we will discuss some of the problems that the Powers of Attorney granted in the United States face when are trying to be executed in Mexico, and also we will mention the requirements that are established in the Washington Protocol for the effectiveness of a Power of Attorney.

The Washington Protocol establishes the minimum requirements that a Power of Attorney must have in order to be used and be effective in every State that is party to this treaty, however in practice, is very often found that Powers of Attorney granted in the United States before an attesting official[2] (which are the people that testify to the authenticity of the Power of Attorney), do not comply with the requirements established in the Washington Protocol.

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In order to understand these problems, we have to say that in the majority of cases the attesting official is a notary public and the responsibilities of this person depends with the laws of each country. The Institution of the Notary Public in Mexico is very different than the one in the United States. The first one comes from the Latin-Notariat that consists in an established system in charge of lawyers that apply the written law instead of the common law. The Latin-Notariat provides *"to the Notary Public the faculty to shape a legal act under his authorship and autonomy, and he must write, save, authorize and record such act in a public instrument.*[3] *"*

1.- Also Venezuela, Brazil, El Salvador,Bolivia, Nicaragua, Paraguay and Colombia signed the treaty.
2.- Notary, registrar, clerk of court, judge or any other official upon whom the law of the respective country confers such functions.
3.- "La práctica del Derecho Notarial". Jorge Ríos Hellig.McGraw Hill.Mexico,1997.

On the other hand, the Notary Public in the United States comes from the Anglo-Saxon Notariat which does not provide the faculties and obligations that the Latin-Notariat possesses. The Anglo-Saxon notary public is a qualified witness and only testifies about the person who signs a document and the identity of that person. He does not write, does not analyze the merits and does not monitor the legality of the act. His charge is temporal and he has no responsibility to qualify the legality of the act that the people are signing before him.

In Mexico, the notary public must be a lawyer, is highly trained and consequentially he possess the ability to write any legal instrument; he is also a legal advisor, prints the legal instrument, he explains it, reads it and authorizes it in the name of the State. He has responsibility for the instrument he testifies.[4]

On the other hand, the notary public from United States is more practical, simpler, and very efficient, but due to the same system that does not allow the legal qualification of the act, the notary only testifies about the grantor's signature and they follow the certification formats that are given by the State they represent[5], which in the majority of cases, are not up to the requirements established in the Washington Protocol.

Grant a Power of Attorney not in accordance with the established in the Washington Protocol could cause undesirable effects at the moment to use it abroad, such as the nullification of a commercial agreement, the possibility of losing a trial in a litigation process, etcetera.

"Grant a Power of Attorney not in accordance with the established in the Washington Protocol could cause undesirable effects at the moment to use it abroad..."

In order to avoid these problems we would like to list the requirements that the certification of a notary public or any authorized attesting official must have for the validity and effectiveness of a Power of Attorney for use abroad. These requirements are contained in the Article I of the Washington Protocol.

1. The attesting official must certify from his own knowledge the identity of the appearing party and his legal capacity to execute the instrument.
2. He must also certify that in case of a representative, that the representative has in fact the authority to represent the company in whose name he appears, and that this representation is legal according to such authentic documents as for this purpose are exhibited to the attesting official and which the latter shall mention specifically, giving their dates, and their origin or source.

4.- Idem.
5.- "Breves comentarios acerca del régimen legal de los poderes otorgados en el extranjero" Werner Vega Trapero. Blog Ius Ibero.Mexico, 2011

3. He must mention the juridical person in whose name the Power of Attorney is executed,
4. The juridical person's home office,
5. Evidence of its legal existence.
6. Certify that the purposes for which the instrument is granted are within the scope of the objects or activities of the juridical person.
7. The attesting official must certify the aforementioned requirements based on the company's documents such as the instrument of organization, bylaws, and resolutions of the board of director or other governing body and such other legal documents as shall substantiate the authority conferred.
8. The attesting official shall **specifically** mention these documents, giving their dates and their origin and all detail possible of the shown documents.

Mexican authorities review very carefully the notary public's certifications, especially points 6, 7 and 8. When the Powers of Attorney do not comply these requirements, local authorities doubt about the authenticity and effectiveness of the document. Attesting officials must mention in as much detail as possible, the documents on which they base their certification.

Besides of the above mentioned requirements, the Power of Attorney granted abroad must be legalized or apostilled in order to be effective in Mexico. The legalization or the apostille of a foreign public document is intended to testify the authenticity of the attesting official's authority.

In this case, U.S. and Mexico are part of the Hague Convention celebrated on October 5th 1961, signed to Abolish the Requirements of Legalization for Foreign Public Documents, ergo, all public documents from United States shall be apostilled instead of legalized.

The apostille must contain the following[6]:

a) Name of the country that issues the apostille.
b) Name and quality of the person who signed the apostilled document and on its case the seal used by him.
c) Date and place of the apostille.
d) Authority that issue the apostille.
e) Sign and seal of the authority that issue the apostille.

In conclusion, Mexico and the U.S. have a strong legal framework applicable to Powers of Attorney. The Washington Protocol is a powerful treaty that if it is used properly, legal and commercial operations are solid and effective. The Washington's Protocol requirements are not difficult to fulfill and we would like emphasize the importance of reviewing the Powers of Attorney before trying to execute them abroad, because the documents signed under a Power of Attorney that does not comply the requirements of this treaty, may face invalidity issues that may cost time, money and effort.

6.- "Breves comentarios acerca del régimen legal de los poderes otorgados en el extranjero" Werner Vega Trapero. Blog Ius Ibero. Mexico, 2011.

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Extract of Mexican Aviation News

Aviation Industry grows in the Republic.

With an investment estimated at USD$1,300 million this year, and the creation of more than 31,000 jobs and exports above 4,000 million dollars, the aviation sector is considered as one of the most dynamic of Mexican industries. The Minister of Economics estimates that aviation sector enterprises have grown 138% since 2006. *El Economista. 09/Jul/12*

United States airlines gain ground.

The market share of US airlines that transport passengers between Mexico and the US grew by 7.8 % last year. The General Directorate of Civil Aviation (DGAC) reports that in 2011 national airlines carried 18.8% of passengers , while US airlines carried 81.2%. This is compared to the 24.7% of passengers that flew on national airlines in 2010. Mexicana's shutdown has opened the doors to the foreign airline competition. *El Economista. 12/Jul/12.*

Mexicana's routes now covered.

In May, reports from the Secretary of Tourism ("Sectur") indicated that there were twenty-eight routes to cover since the Mexicana de Aviación shutdown. These routes have now been covered by competitors of Mexicana and the aviation market is normalized, said Sectur. The next step now is for airlines to open new routes. *Milenio Diario. 17/Jul/12.*

Airlines: Do not limit the saturation of the AICM.

The saturation of schedules at the International Airport of Mexico City (AICM) and the lack of infrastructure there do not obstruct the growth of foreign airlines that are starting to expand their operations to other alternative destinations such as Guadalajara, Monterrey, Queretaro, Puebla, Toluca and Guanajuato. National airlines have consistently complained about the saturation of operations at the AICM and that this blocks the growth of aviation in Mexico. (The CEO of the AICM denies that there is such saturation.) *El Universal. 18/Jul/12.*

An initiative to control Air Tariffs.

The Secretary of the Senate's Commission for Commerce and Industrial Promotion presented an initiative to control and set reasonable limits on air fares increases and tourist services over the holiday season. The objective of this initiative is to open up competition and development of the sector without affecting airlines. This initiative was born due to constant complaints regarding ticket prices that have increased up to a 100%. This affects both economic and tourism sectors in Mexico. *La Crónica de Hoy. 23/Jul/12.*

Another runway at the Monterrey´s Airport.

The Ministry of Communication and Transport (SCT) plans to purchase 713.17 hectares for the Monterrey International Airport, in order for the North Central Airport Group (OMA) the concessionaire, to construct a second runway in order to increase the capacity of future air operations. The investment project is nearing completion and the SCT is predicted to be investing a total of 1,984.4 million Mexican pesos. *Milenio. 24/Jul/12.*

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