

**Russia has Created an Exemption from Import VAT for Business Jets - What's Next?**

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Russia has during 2019 taken the first two most important steps to create normal market conditions for the development of civil aviation in Russia. Step one was to shut down the use of foreign-registered aircraft that were not customs cleared for commercial use on charter flights within Russia and other countries within the Eurasian Union. The removal of illegal charter flights from the market has removed the largest impediment to the development of a law-compliant aircraft charter business within Russia. Step two comes into effect as of January 1, 2020 when Russia will no longer impose value added tax (VAT) on the import of civil aircraft into Russia for any purpose, including for commercial use on charter flights. The exemption from import VAT comes in the form of a new zero percent (0%) rate of VAT on the import of civil aircraft as of January 1, 2020.

Russia will now find out whether these changes to financial and legal calculations underlying possible future investments into aircraft will be sufficient to stimulate aircraft transactions in Russia. Will Russian corporations and high net worth individuals be persuaded to import additional aircraft into Russia now that import VAT may lawfully be avoided? Will Russian operators and foreign operators of aircraft be able to make viable business plans to place additional aircraft into service on commercial and private flights in Russia? Will aircraft finance companies and banks be willing to finance aircraft to be used on commercial and private flights within Russia?

Notwithstanding the removal of import VAT, macroeconomic circumstances remain adverse. The Russian economy is under significant pressure. Global aviation finance businesses are skeptical about extending credit for investment in aviation assets and businesses within Russia. Some global aircraft finance companies are prohibited from extending credit to certain Russian aviation concerns.

Yet, much seems now possible that was previously effectively blocked by import VAT and the prevalence of illegal charter flights. Committed market participants will, no doubt, find viable paths forward to grow their aviation businesses in Russia. It is likely true that those who

make the first moves to take advantage of the new tax and regulatory circumstances in Russia will reap a reward when macroeconomic circumstances in Russia improve.

At aircraft charter brokerage events in the summer of 2019 there was universal agreement that there was practically no inventory of aircraft available for domestic charter flights within Russia and the Eurasian Union. The charter brokerage business was suffering and nearing insolvency due to a lack of inventory to sell. Those relatively few aircraft that were available for legal domestic charter flights, which are operated by those few Russian charter operators who have Russian registered, customs cleared aircraft, are overbooked. Those aircraft were performing multiple charter flights per day, and were unavailable for charter brokers to market to other charter customers looking for flights.

The large unsatisfied demand for charter flights within Russia and the Eurasian Union in late 2019 would seem to create a business case for a large number more aircraft to be introduced into the Russian marketplace. Satisfying this demand is the work ahead. It will be undertaken by those Russian owners and operators of aircraft, and those Western owners and operators of aircraft who can be persuaded that acquiring and placing a number of aircraft in Russia is a valuable opportunity in the global aviation market going into 2020 and further into the future. Also, although Russian corporations that own and operate aircraft could previously recapture import VAT, the removal of this cost altogether should serve to stimulate purchases of aircraft by Russian corporations.

## **1. The Exemption from Import VAT for Civil Aircraft**

On September 29, 2019, President Putin signed into law Russian Federation Federal Law N 324-Φ3 which had been approved by the State Duma on September 19 and by the Federation Council on September 25 (the "Civil Aviation VAT Exemption Law"). The law shall enter into force on January 1, 2020 and is named "On Amendments to Article 24.2 of Part One and Part Two of the Tax Code of the Russian Federation".

The Committee of the Council of the Federation on the Budget and Financial Markets issued a report on the Civil Aviation VAT Exemption Law which summarized that the law was developed by the Government of the Russian Federation to improve tax incentive measures for stimulation of the development of civil aviation. To achieve this goal, a number of changes are introduced into the Tax Code of the Russian Federation (hereinafter - the Code).

The law establishes the rate of 0% for value added tax (hereinafter referred to as VAT) and the conditions which are required for exemption from VAT for civil aircraft imported into the territory of the Russian Federation that are registered in the State Register of Civil aircraft of the Russian Federation.

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The exemption from import VAT, the 0% rate, also applies, very importantly, to civil aircraft registered in the state register of civil aircraft of a foreign state, for which, in accordance with an international agreement of the Russian Federation, the functions and obligations of the state of registration are fully or partially transferred. The law is referring to aircraft that are registered in a country that has an "83-bis Agreement" with Russia, an agreement within the meaning of Section 83-bis of the Convention on International Civil Aviation (the "Chicago Convention"). According to the law, exemption from VAT on the import of aircraft registered in the state registry of civil aircraft of a foreign state is allowed until January 1, 2023.

Article 83 bis of the Chicago Convention provides:

Transfer of certain functions and duties

a) Notwithstanding the provisions of Articles 12, 30, 31 and 32 a), when an aircraft registered in a contracting State is operated pursuant to an agreement for the lease, charter or interchange of the aircraft or any similar arrangement by an operator who has his principal place of business or, if he has no such place of business, his permanent residence in another contracting State, the State of registry may, by agreement with such other State, transfer to it all or part of its functions and duties as State of registry in respect of that aircraft under Articles 12, 30, 31 and 32 a). The State of registry shall be relieved of responsibility in respect of the functions and duties transferred.

b) The transfer shall not have effect in respect of other contracting States before either the agreement between States in which it is embodied has been registered with the Council and made public pursuant to Article 83 or the existence and scope of the agreement have been directly communicated to the authorities of the other contracting State or States concerned by a State party to the agreement.

Accordingly, in order for an aircraft to be flown, legally, on commercial charter flights within Russia, that aircraft must be registered in Russia or registered in a country that has entered into an Article 83bis Agreement with Russia according to the Chicago Convention, and then this foreign-registered aircraft must be placed on to the certificate of a Russian operator. There are seven countries outside of the former Soviet Union with which Russia has 83-bis Agreements. These are: (1) Ireland, (2) Turkey, (3) Switzerland, (4) Bermuda, (5) Austria, (6) Bulgaria, and (7) Malawi.

There are other countries where Russians commonly register aircraft, but aircraft registered in these countries will not be eligible to be placed on a Russian AOC. Examples of other countries that do not have 83-bis Agreements with Russia include: in tax-haven jurisdictions - the

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Bahamas, and the Cayman Islands; and in Europe - the UK, Isle of Man, Finland, Germany, Malta, and Portugal. However, nothing in the Civil Aviation VAT Exemption Law prevents additional countries from setting up 83-bis Agreements with Russia. For example, Malta may be willing to set up an 83-bis Agreement with Russia.

The rate of 0% import VAT is also provided for aircraft engines, spare parts and accessories products intended for construction, repair or modernization on the territory of the Russian Federation of civil aircraft, and a number of other products necessary for the development, creation and testing civil aircraft and aircraft engines.

The law regulates the time periods for fulfillment of the conditions for exemption from VAT of the specified imported goods and the actions of regulating authorities for compliance with the requirements application of the exemption from VAT, and the actions of a taxpayer in case of failure to comply with requirements of the exemption. Requirements for a taxpayer are set out in the event a civil aircraft is excluded from the State Registry of civil aircraft of the Russian Federation, or the registry of civil aircraft of a foreign state.

The law also exempts from VAT the import to the territory of the Russian Federation by persons who have received the status of a participant in special administrative region in accordance with Federal Law of August 3, 2018 No. 291-ФЗ "On Special administrative regions ("SARS") in the territories of the Kaliningrad region and the Primorsky Territory (hereinafter referred to as a SAR participant). And, when determining the tax base for corporate income tax, income is not considered which is received from the operation and sale of vessels that are registered by Persons who have received the status of a participant in an SAR. In addition, for SAR participants, aircraft registered in the State Register civil aircraft are not included as objects of taxation.

The report of the Federal Assembly Council of the Federation Committee on Economic Policy adds that the law will contribute to the development of domestic aircraft industry, and the establishment of service centers for maintenance and repair aircraft of Russian airlines on the territory of the Russian Federation.

The Civil Aviation VAT Exemption Law amends Article 150 of the Tax Code which enumerates different categories of goods that are exempt from import VAT by adding subparagraphs 20-22 with the following content:

20) civil aircraft [are subject to 0% import VAT] upon the condition that a copy of a certificate of state registration of a civil aircraft in the State Register of Civil Aircraft of the Russian Federation is submitted to the customs authority...[ or] an obligation of the taxpayer, in a form approved by the federal executive body authorized to control and supervise customs matters, within 90 calendar days from the date of registration of a customs

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declaration... [to submit] a copy of the certificate of state registration of a civil aircraft in the State Register of Civil Aircraft of the Russian Federation..."

If a civil aircraft is removed from the State Register of Civil Aircraft of the Russian Federation, the amount of tax calculated during the customs declaration of a civil aircraft which was exempted from payment upon importation of a civil aircraft as provided for by this subparagraph, shall be paid by the taxpayer who submitted to the customs authority a copy of a certificate of state registration of a civil aircraft in the State Register of Civil Aircraft, [unless due to]:

- the write-off of a civil aircraft or its decommissioning due to the inability to use the given vessel for its intended purpose (as a means of transportation);
- the sale of a civil aircraft or transfer on other legal grounds of the right of ownership of it to a foreign state, or to a foreign citizen, a stateless person or a foreign organization, provided that the civil aircraft is removed from the territory of the Russian Federation.

21) civil aircraft registered in the state register of civil aircraft of a foreign state, on the condition of submission to the customs authority of a certificate of registration of a civil aircraft in the state register of civil aircraft of a foreign state, and in accordance with an international treaty of the Russian Federation, the functions and duties of the state of registration have been transferred to the Russian Federation, in whole or in part.

In case of removal of data on a civil aircraft from the register of civil aircraft of a foreign state, in regard to which, in accordance with an international treaty of the Russian Federation, the functions and duties of the state of registration have been transferred to the Russian Federation in whole or in part, the amount of tax which would have been due upon customs declaration of a civil aircraft, but which was exempted upon import of a civil aircraft pursuant to this subparagraph, shall be paid by the taxpayer...

The provisions of this paragraph do not apply to the removal of data on a civil aircraft from the register of civil aircraft of a foreign state, which, in accordance with the international treaty of the Russian Federation, have transferred to the Russian Federation fully or partially the functions and duties of the state of registration in the following cases:

- submission to the customs authority of a certificate of state registration of a civil aircraft in the State Register of Civil Aircraft of the Russian Federation;
- write-off of a civil aircraft or its decommissioning due to the inability to use the aircraft for its intended purpose (as a vehicle)...

22) aircraft engines, spare parts and components intended for the construction, repair and (or) modernization of civil aircraft on the territory of the Russian Federation, as well as printed publications, prototypes and (or) their components, necessary for the development, creation and (or) tests of civil aircraft and (or) aircraft engines...

[Further] [i]n the case of transfer under a lease agreement of a civil aircraft on the territory of the Russian Federation, if within 90 calendar days from the date of transfer under a lease agreement (lease) of a civil aircraft, the state registration of a civil aircraft in the State Register of Civil Aircraft of the Russian Federation has not been implemented, the tax base for the transfer services of civil aircraft is determined by the tax agent as the cost of these services under a lease (leasing) agreement.

Accordingly, aircraft may be acquired by a Russian operator through a purchase transaction or a lease transaction, and no import VAT would be payable. Also, foreign-registered aircraft may be leased to a Russian operator and, if there is an 83-bis Agreement in place between that foreign country and Russia, no import VAT would be due. With these new rules coming into effect as of January 1, 2020, it may be prudent for all existing cross border aircraft lease agreements with Russia operators to be revised and replaced by new lease transactions that would not be subject to import VAT.

## **2. The Exemption from Import Duties for Civil Aircraft**

The Eurasian Economic Union United Customs Tariff Commodity Nomenclature for Group 88 Aircraft has also been amended effective January 1, 2020. The generally applicable customs duty rate for civilian aircraft is 10%. See Line 8802 20 000 1. However, there is a 0 percent duty rate for aircraft having an empty weight not exceeding 20,000 kilograms, and also for aircraft with seating for not more than 50 passengers. See lines 8802 30 000 2 and 8802 40 001 and 8802 40 001 1.

## **3. Possible Legal Structures for Russian Corporations and Russian Operators to Acquire Additional Aircraft**

Given that the exemption from import VAT on the import into Russia of an aircraft registered in the state registry of civil aircraft of a foreign state is allowed until January 1, 2023, and given that global aircraft finance companies strongly prefer to provide financing under the laws of a jurisdiction outside of Russia for an aircraft to be operated in Russia, it is highly probably that from January 1, 2020 to January 1, 2023, aircraft acquisitions for Russian corporations and operators will be accomplished under the laws of a country which has or will set up an 83-bis Agreement with Russia. It also seems likely that all lease and loan

documentation will provide for a term ending on January 1, 2023 and for the return of leased or financed aircraft unless the transition period allowing for continuance of registration of an aircraft outside of Russia is prolonged beyond January 1, 2023.

It would seem likely that a Russian corporation desiring to purchase an aircraft with financing from a foreign creditor will organize a special purpose company (SPC) in the foreign jurisdiction in which the aircraft is to be registered, a country having or obtaining an 83-bis Agreement with Russia. The Aircraft Purchase Agreement would provide that the SPC is to buy the Aircraft. The loan documentation would be between the creditor and the SPC. There would be a non-exclusive lease of the Aircraft from the SPC to the operator in Russia. The Russian operator would act as the importer of the Aircraft to Russia and file a customs declaration with the Russian Customs Service to import the Aircraft to Russia and claim the 0% rate of import VAT and exemption from customs duties upon the import of the aircraft. As the aircraft would be customs-cleared, it could be used on commercial charter flights within Russia to earn revenue for the SPC. The Russian corporation, SPC and operator would enter into an Aircraft Management Agreement ("AMA") providing that the operator may operate the Aircraft on charter flights, or exclusively on private flights. Maintenance of the aircraft would likely be required to be conducted outside of Russia and in accordance with EASA or FAA and manufacturer requirements.

#### **4. A Step Plan to Place an Imported Aircraft on to a Russian Operating Certificate**

As the imported aircraft is to be operated by a Russian operator, a detailed step plan would be required for all work required to place the aircraft on to a Russian operating certificate. The established Russian operators know this process well, and the entire process may require several months, or more if an aircraft has not previously been type certified in Russia.

#### **5. A Step Plan to Register an Aircraft in a Country that has an 83-bis Agreement with Russia**

If an aircraft is already owned and registered outside of Russia, or is acquired outside of Russia and is not currently registered in a country that has an 83-bis Agreement with Russia, then it will be necessary to move the aircraft registration to a country that has an 83-bis Agreement. The aircraft will need to be moved to the country having the 83-bis Agreement with Russia, de-registered from its current country of registration, possibly leased or sold to a company in the country having an 83-bis Agreement with Russia, and then registered in the country having an 83-bis Agreement with Russia. There would need to be a lease running from the off-shore owner or lessor to the Russian operator. There would need to be an amendment to the 83-bis Agreement in question to add the specific aircraft in question to that 83-bis Agreement, requiring intergovernmental coordination.

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In conclusion, it is likely that the removal of illegal charter flights from the Russian domestic market, and the creation of a zero percent (0%) rate of VAT for the import of civil aircraft into Russia commencing as of January 1, 2020 will strongly stimulate the placement into service in Russia of a substantial number of business aircraft in coming years. Where financing is required, or desired, for a Russian corporation, operator or individual to purchase a desired aircraft, it is likely that the focus will be on accomplishing the purchase transaction and the financing transaction under the laws of a country having an 83-bis Agreement with Russia and the aircraft will be registered in that foreign country. Marks and Sokolov and Atlantic Aviation Legal Services would be delighted to assist you in accomplishing your aircraft transaction.