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Current Tax and Regulatory Issues for Business Aviation in Russia

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1. Russian Tax Planning Issues in Importing a Foreign-Registered Aircraft to Russia, as Opposed to Using a Foreign-Registered Aircraft in Russia

Russian import VAT - 18% of the declared customs value.

- At time of import, or up to 24 months.

Russian customs duties - Was 20% of the declared customs value.

- Now, business jets are exempt from customs duties, if less than 50 seats.

Russian property tax - 2.2% of value

- Annually.



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2. Potential Removal of Import VAT on Business Jets

The import VAT tax rate of 18% is single largest reason that Russian owned business jets are not commonly registered in Russia.

There were press reports in March 2012 that the Russian Ministry of Transportation supports a 0% import VAT rate on all aircraft. Similar statements were made by Ministry officials in 2010.

However, no specific Ministry proposals have been published.

Staff members say they will advance a proposal “when they are told to do so” by higher-ups.



3. What to do while the 18% import VAT is still in effect?

For large Russian corporations, import VAT may be rapidly recovered by being set off against VAT inputs. Severstal has given a presentation about this, and recovered VAT on two Challenger 604's over 5 months.

Alternatively, Russian corporations may set up an arrangement providing for extensive "private" use of a foreign registered aircraft in Russia, without customs clearing the aircraft.

For wealthy Russian individuals, import VAT would become an unrecoverable sunk cost, so they will register their aircraft outside of Russia.

For operators, there are some tax planning strategies to minimize Russian import VAT.



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4. Use of 83-bis and a Cross Border Lease

In order for a foreign-registered 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 placed the aircraft on a Russian AOC.

Seven countries outside of the former Soviet Union have 83-bis Agreements with Russia: (1) Ireland, (2) Turkey, (3) Switzerland, (4) Bermuda, (5) Austria, (6) Bulgaria, and (7) Malawi.



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5. What does 83-bis say?

- If an aircraft is registered in a contracting state, and
- is leased to an operator in another contracting state, then
- certain functions and duties of country of registration may be transferred to country of the lessee, including :

Article 12 Rules of the Air for flight and maneuver,

Article 30 Requirements for aircraft radio equipment,

Article 31 Issuance of certificates of airworthiness, and

Article 32(a) Pilot licensing requirements.



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6. Calculation of Import VAT for a Leased Aircraft

In the case of an aircraft leased into Russia to be placed on a Russian AOC and operated commercially, the Russian lessee and AOC holder must file a customs declaration with the Russian Customs Service.

The key issue is the proper calculation of the declared customs value of the aircraft.

There is good authority that the declared customs value may be the sum of the lease payments due over the term of the cross border lease.

18% of the total cross border lease payments for a lease term of one or two years is much less than 18% of the value of an aircraft.



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7. Likely Customs Service Position

The Customs Service will likely contest a declared value based on lease payments due.

We think the lessor and lessee should win on appeal since the aircraft has not been purchased by a Russian company.

The Customs Service will argue the declared value ought to be:

- the full fair market value of the aircraft,
- the insured value of the aircraft, or
- the total amount of lease payments that would be due under a lease for the aircraft's entire useful life, not just this lease term.



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8. Issues in Determining Customs Value

It is problematic if the cross border lease provides for a lease fee calculated with regard to the number of hours flown. This does not result in a definite value to show on a customs declaration.

It is better to refer to an exact amount due under a senior lease if the aircraft is subleased into Russia, or a fixed lease payment regardless of hours of usage.



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9. Time Period for Payment of Agreed Customs Duties

If a Russian industrial concern desires to allow commercial usage of an imported aircraft in Russia, the choice will be to pay the full amount of import VAT, calculated as 18% of the declared value, in a lump sum at the time of importation and then to rapidly recover the import VAT by offsets.

In the case of a foreign operator placing an aircraft on a Russian AOC, the choice will be to use the "temporary import regime" and pay import duties over the lesser of the term of the lease, or a maximum allowable period of 24 months.



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10. Use of a Cross Border Lease Without 83-bis

We are aware of a strategy of leasing aircraft to a Russian legal entity without making use of an 83-bis agreement.

The purpose is to establish with the Russian Customs Service that an aircraft is customs-cleared, so that the Russians Customs Service will not challenge commercial use of the aircraft within Russia. This approach assumes Rosaviatsia will not know whether an aircraft is used privately or commercially, and cannot arrest an aircraft, so, in practice, this should work.

However, use of a foreign-registered aircraft on commercial flights within Russia, except pursuant to an 83-bis agreement and placing the aircraft on a Russia AOC remains prohibited cabotage.



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11. Use of a Cross Border Lease Without 83-bis

We cannot endorse the strategy of attempting to “split the regulators” and satisfy the Russian Customs Service that an aircraft is customs-cleared, while violating restrictions on cabotage that perhaps may not be easily policed by Rosaviatsia.

All risks of illegal cabotage flights would remain in effect, including denial of insurance coverage in the event of an unfortunate incident.

Owners and their banks may not be aware of the substantial risks involved in illegal cabotage flights. These risks were proven to exist after a Cessna crash in Russia some years ago.



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12. Private Use in Russia of a Foreign Registered Aircraft

This is the dominant case with Russian-owned, foreign-registered aircraft.

These aircraft are not customs-cleared in Russia, and no import VAT is due.

There is a Lease Agreement from the foreign owner to a Russian Company in Russia.

The aircraft is registered in a European or other jurisdiction, not limited to 83-bis countries, and not limited to countries that register aircraft for commercial use.



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13. Private Use in Russia of a Foreign Registered Aircraft

A permit is received from Rosaviatsia providing for operation of the foreign-registered aircraft within Russia "in the interests of" the Russian lessee, pursuant to a series of one-time permits.

The Rosaviatsia permit may list a large number of persons (20 or 30 or more) who may be passengers who are affiliated with the Russian lessee.



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14. Picking up passengers on Private Flights / The Rosaviatsia Position

Russia does allow foreign-registered aircraft to be flown into Russia, and to make stops in multiple Russian cities, and to take onboard passengers for flights within Russia, provided that all such flights are “in the interests of the possessor of the aircraft.”

Such flights are made pursuant to serial issuances of "one-time permits" by Rosaviatsia.



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15. Picking up passengers on Private Flights / The Rosaviatsia Position

The authority for one-time permits is found in Decree No. 69 of the Federal Air Navigation Service.

If the passengers are restricted to the persons named in the permit received from Rosaviatsia, it seems well established that the transportation of such persons is on a private basis in the interests of the Russian lessee, and such flights do not comprise prohibited commercial flights.



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16. Picking up passengers on Private Flights / The Customs Service Position

Russia is now a party to the Customs Code of the Customs Union (the “CCCU”).

According to the CCCU, foreign-registered business aircraft are exempted from Russian import duties and import VAT if the aircraft are owned by a foreign individual or entity and are used on non-commercial flights within the Customs Union, including within Russia.



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17. Picking up passengers on Private Flights / The Customs Service Position

This exemption is set out in Customs Union Commission Decision No.662.

This exemption from import duties and import VAT does not apply to aircraft used on charter flights within Russia, and flights "aimed at deriving income".



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18. Picking up passengers on Private Flights / The Customs Service Position

The exemption applies to aircraft if:

- 1) the maximum seating capacity of the aircraft does not exceed 19 passengers;
- 2) the aircraft is owned by foreign legal entities or individuals;
- 3) the aircraft is used in the customs territory of the Customs Union for occasional flights (i.e. for the flights not included in a schedule of commercial flights); and
- 4) the use of the aircraft is not aimed at deriving income.



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19. Picking up passengers on Private Flights / The Customs Service Position

Aircraft satisfying these criteria may be cleared for use in Russia under the temporary import customs procedure for a period not exceeding 30 days, provided the total period of time the aircraft may be in the customs territory of the Customs Union may not exceed 180 calendar days within a calendar year.

It is not allowed to pick up passengers in Russia and drop them off within the territory of the Customs Union if the aircraft is not customs-cleared. See Clause 2 Article 344 of the CCCU.



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20. What Would Be A Better Idea?

The current practice in Russia of allowing extensive use in Russia of foreign-registered aircraft on real and purported private flights within Russia strongly incentivizes Russian owners to register their aircraft outside of Russia.

Arguably, a better alternative would be for Russia to create an exemption from import VAT for business aircraft that are imported to Russia and will be used commercially within Russia.

Such an exemption from import VAT would be consistent with the EU Directive that authorizes EU countries to exempt aircraft from import VAT if the aircraft are imported to a particular European country to be used commercially.



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21. What Would Be A Better Idea?

Such an approach would help limit "gray aviation" in Russia, the extensive use of aircraft that are registered for private use in Europe or elsewhere, and imported to Russia for private use, but which are, in fact, used on commercial flights within Russia.

Such an exemption from Russian import VAT would facilitate:

- a business case for investment in the Russian airport infrastructure for business aviation,
 - employment of Russian pilots and mechanics,
 - a business case for more FBOs and service centers, and
 - a level playing field between Russian and European operators.
- Thank you for your attention!