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Global minimum tax rate

Its impact on the world of aviation

There has been much commentary recently about the OECD's proposal for countries to introduce a global minimum taxrate. This follows on from the OECD's BEPS project and is part of a series of measures which were initially proposed witha view to updating the global tax system in order to appropriately tax transactions in the digital economy. As a global industry, the aviation sector is also exposed to the possible implications of these new rules. Here we consider some of the key implications for the industry. The below is a very high-level summary of what is an incredibly complex proposal; to work effectively they will need to be implemented in broadly identical form by all relevant jurisdictions. It is therefore not possible to give a firm general view as to how a particular transaction will be affected by the rules as it will depend on the nature of the group of which the entities form part as well as the jurisdictions involved and whether they have implemented the rules in full or in part. However, jurisdictions have begun to implement the rules with effect from January 1, 2024, and so the rules could affect transactions that have already been entered into. The UK has implemented the rules and many other European jurisdictions are beginning to; the US has not yet implemented these rules but is thoughtto be paving the way for a possible implementation in due course.

What is OECD Pillar 2?

OECD Pillar 2, where implemented by a national jurisdiction, requires multinational enterprises (**MNEs**) with a consolidated group turnover of more than €750m to calculate the effective tax rate in each jurisdiction in which it operates. To the extent that that effective tax rate is less than 15 per cent, the rules can require a top-up tax to be paid in the relevant jurisdiction – or where that jurisdiction has not implemented Pillar 2 rules, another jurisdiction in the group can impose an equivalent top-up amount. These calculations are primarily based on the accounting profits of the group and each relevant entity compared to the amount of corporate taxes actually paid in order to determine the effective tax rate, although there are specific adjustments required to take account of certain types of tax credit and tax loss assets. This means that Pillar 2 top-up amounts could be charged where a jurisdiction has a higher corporate tax rate than 15 per cent (because the actual tax rules in that jurisdiction produce a different result to the Pillar 2 calculation).

This also means that, effectively, a top-up amount of corporate tax could arise in a company in a jurisdiction that is already paying an appropriate amount of tax because it is a top-up amount in respect of another group company in a lower tax jurisdiction that has not implemented Pillar 2.

For affected groups, there are intricacies in the way the rules interact with domestic tax legislation and how the implementation of the rules across jurisdictions interacts. This is outside the scope of this note; however, we consider some key issues below.

Implications for the aviation sector

Many airlines are likely to be sufficiently large in size to be required to implement the Pillar 2 rules. Whilst this is likely to introduce complexity into the tax compliance process, the operational side of an airline's business is typically located in the jurisdictions in which it operates and so, unless those jurisdictions have a low-tax regime, the application of Pillar 2 may not make significant differences overall (albeit introducing substantial additional compliance burdens).

However, transactions that involve the leasing of aircraft, whether within an airline group or as part of the wider aircraft leasing market, could raise more significant issues. Typically, an aviation leasing structure will be based on the premise that the lessor should not be exposed to significant tax beyond the tax on its operating margin – until, at least, the aircraft is sold in cases where the lessor retains the residual value. Because of the impact of tax depreciation, which is often more favourable than accounting depreciation, it is possible that an aircraft lessor will be regarded as undertaxed in its own jurisdiction for a given accounting period. Similar issues can arise in relation to lessors that are taxed under a special tax regime, as is often the case with special purpose entities. Care will therefore need to be taken by lessors to ensure that they do not suffer taxes unnecessarily where there is no real corresponding profit. The rules are still developing and so it is likely that in due course there will be specific rules to deal with special purpose taxation regimes; however, this remains an area of development.

There is also a risk that aircraft lessors are taxed on their profits in a jurisdiction other than the jurisdiction of residence ofthe actual lessor entity. This would be the case (for example) where the lessor is resident in a jurisdiction that has not implemented the Pillar 2 rules, but is part of a wider group including members in jurisdictions which have implemented the rules. In these circumstances, it is possible that the top-up tax attributable to the profits of the lessor would be charged on a different entity and a different jurisdiction to that of the lessor. This may have implications for the drafting ofthe tax indemnity in the relevant lease as this would typically operate by reference to taxes imposed on the lessor itself, with carve outs by reference to the jurisdiction of residence or operation of the lessor.

Next steps

The landscape around Pillar 2 is changing rapidly and, as such, many groups are only beginning to consider the implications now. The OECD rules are anticipated to be fleshed out with further guidance as the real-world impact of therules becomes more apparent, and this may include further guidance on the use of SPCs in particular types of transaction. There is also an ongoing process in relation to how individual jurisdictions are introducing these rules and, indeed, which jurisdictions will implement them at all. There is therefore no industry-wide expectation as yet as to how these rules willimpact the aviation sector (if at all) and, if so, how the risk will be allocated in documentation. However, as the rules develop, it will be important for parties to monitor the potential implications.

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