



CO-LEASING PRACTICES IN THE PRC

The practice of “co-leasing” has been a feature of some cross-border aircraft operating leases to PRC airlines for a number of years.

Essentially, this involves two entities being named as lessee under the aircraft lease: the operating airline and one other.

In our experience, this is commonly:

- for credit support; or
- to assist with the administration of certain taxes in the PRC.

Co-leasing for credit support

Co-leasing for credit support typically arises where an airline group intends to have an aircraft operated by a subsidiary airline, with a weaker credit than its parent (which may also be an airline).

The usual credit protection sought by lessors is a guarantee.

However, if a guarantee is not available (e.g., due to corporate authority or regulatory reasons), the parties might agree to include the parent as co-lessee under the lease, such that each co lessee is "jointly and severally" liable for all lessee obligations under the lease.

The enforceability of such arrangement as compared with a direct parent guarantee should be considered carefully with PRC counsel.

Co-leasing for administration of taxes

It is also relatively common for a PRC airline to request the addition of a party to an aircraft lease to assist with the administration of taxes payable under that lease.

Traditionally, this has been done by making an appropriate import/export company a "consenting party" to the relevant lease, allowing the consenting party, amongst other things, to apply for and administer withholding VAT and related surcharges in connection with rental and other payments made by the airline under the lease.

This process has recently become subject to change following a regulation (the "Regulation") in October 2017 by the State Tax

Bureau of China in respect of its new requirements on VAT declarations, with the Regulation's requirements having come into force on 1 May 2018.

The Regulation requires that the supporting documents in relation to such VAT administration must corroborate each other. This means that the party seeking to administer the tax payments must demonstrate its right to make such tax payments.

This may be difficult to establish under the traditional "consenting party" practice, where the consenting party has no contractual right to the rent, to which the tax arrangements relate.

Our recent experience is that some airlines are requesting that the applicable import/export company is made co-lessee under the lease. The aim is to establish its joint and several liability for rent payments to provide acceptable corroborating evidence to allow the PRC tax authorities to continue the involvement of the relevant import/export company in the administration of taxes.

Considerations for lessors

Lessors considering co-leasing structures should mitigate risks as follows:

- obtain advice to ensure the joint and several liability of the co-lessees allows continued enforceability against the intended counterparty;
- ensure that documentation allows for practical management of the lease, identifying the primary contact for lease

management purposes and to ensure that fulfilment of lessor obligations in favour of one lessee constitutes fulfilment in respect of all lessees; and

- take local PRC advice as regards both the regulatory framework and the enforceability of such arrangements against the relevant counterparties.

For further information, please contact the author of this briefing:



DAVID BROTHERTON

Partner, Singapore

T +65 6411 5360

M +65 8121 5029

E david.brotherton@hfw.com

This content should not be construed as constituting a legal opinion on the application of PRC law and is based solely on our experience as international counsel representing clients in relation to their business in the PRC.

HFW has over 550 lawyers working in offices across the Americas, Europe, the Middle East and Asia Pacific. For further information about our aerospace capabilities, please visit hfw.com/aerospace

hfw.com

© 2018 Holman Fenwick Willan LLP. All rights reserved. Ref: 00756

Whilst every care has been taken to ensure the accuracy of this information at the time of publication, the information is intended as guidance only. It should not be considered as legal advice. Holman Fenwick Willan LLP is the Data Controller for any data that it holds about you. To correct your personal details or change your mailing preferences please email hfwenquiries@hfw.com

Americas | Europe | Middle East | Asia Pacific