

## Legal Aspects of Airfinance in Australia

### Registration of aircraft

Aircraft flown within Australia must be registered in accordance with the *Civil Aviation Act 1988 (Cth)*.<sup>i</sup> The Civil Aviation Safety Authority (CASA) maintains the Australian Civil Aircraft Register which is available to search on the internet<sup>ii</sup> and is indexed by registration marking, airframe serial number, aircraft model and company (owner/operator) name. The prefix for registered Australian civil aircraft is “VH”. Australia does not maintain a register for aircraft engines.

The principle regulations on registration of aircraft and related matters are set out in Part 47 of the *Civil Aviation Safety Regulations 1998 (Cth)* (CASR). The Certificate of Registration for an aircraft is issued to the owner of the aircraft, the “registration holder”. Where the owner does not intend to be the operator, or does not satisfy the criteria necessary to be the operator of the aircraft, the owner is required to nominate an “eligible person” to be the “registered operator”.

The Regulations do not adequately define ownership, but do provide that an “owner” includes a “part-owner”. The imprecise terminology probably means that “owner” includes parties with a wide range of proprietary interests. A shortcoming of the Regulations is that only one party can be named as registration holder and additional proprietary interests cannot be noted on the Register. It is not uncommon for the registration holder to be the beneficial interest holder but not the legal title holder.

The registration holder does not have to be an Australian entity but does have to be a form of legal entity recognised under Australian law. Individuals in partnership and certain other business structures are not recognised as legal entities in Australia.

A registration holder who is not also the registered operator has no statutory obligations in relation to operation and maintenance of the aircraft. The registered operator is the ultimate party responsible for ensuring compliance with statutory airworthiness and maintenance requirements.<sup>iii</sup>

To be a registered operator, a party must satisfy the requirements of an “eligible person” as prescribed in Part 47 of the CASR. The eligibility requirements include an Australian nexus. For foreign corporations not registered in Australia, registration to carry on business in Australia may be sufficient. Once registered,



certain tax reporting and other obligations ensue. To be registered as an operator for commercial purposes<sup>iv</sup> an entity must hold a current Air Operator Certificate (AOC) issued by CASA requiring the operator, among other things, to have an Operations Manual approved by CASA detailing the operator's processes and procedures for the conduct of safe aircraft operations and the management controls and structure in place for those purposes. The Ops Spec<sup>v</sup> of an AOC describes navigational approvals, permissions and other operational information about the operator. AOC and Ops Specs certificates are unavailable online and these will need to be requested directly from the operator. However a basic informational search can be undertaken on the CASA website to determine an AOC holder's permitted flight operations.

***Dealings on the Register.*** CASA has prescribed forms to be used for changes to the Civil Aircraft Register. In respect of transfer of ownership, CASA currently only accepts for filing hardcopy forms with physical signatures. Some minor details can be updated via CASA's online self-service portal, however users must be registered.

Dealings will not be registered unless the proper form has been used and it has been executed by the registered party by its corporate officer or another party with a letter of authority from the registered party. From a financier's point of view, it is critical that a letter of authority in the proper form be obtained from the registration holder so if necessary the aircraft can be transferred to a new owner without the need to involve the current registration holder. CASA guidelines on letters of authority include requirements for:

- (a) who has authority to sign the letter;
- (b) restrictions on the period of validity of the letter; and
- (c) the purposes for which the authority is being given.

Caution must be exercised as certain de-registration powers of attorney may not be recognised by CASA as valid letters of authority.

Usually a sale contract will require transfer of title to be effected by way of a bill of sale. Because the Civil Aircraft Register is not a register of title, a purchaser must rely on their own due diligence and warranties from the vendor, such as a warranty of absolute legal and beneficial ownership free from all encumbrances.

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## Debt Security Issues

***Personal Property Securities.*** In December 2009 the *Personal Property Securities Act 2009* (Cth) (PPSA) received royal assent and is due to commence operation in October 2011. The new personal property security laws will radically change the personal property regimes that currently exist in Australia (described below) by replacing them with a single national system for the recordation of security interests in personal property. The primary definition of security interest is: "an interest in relation to personal property provided for by a transaction that, in substance, secures payment or performance of an obligation (without regard to the form of the transaction or the identity of the person who has title to the property)".<sup>vi</sup> Regulation 1.6 of the *Exposure Draft of the Personal Property Securities Regulations 2010* (Cth)<sup>vii</sup> expressly extends the concept of personal property (goods) to include "aircraft" (including airframes and engines), and "helicopters", defining those terms consistently with the definitions contained in the Aircraft Protocol to the Cape Town Convention.<sup>viii</sup> The Regulations contain a definition for "small aircraft" to cover aircraft not covered by the Cape Town terminology. Under the reform, registrations, priorities and enforcement will apply to securities traditionally used in aircraft financing such as fixed and floating charges, chattel mortgages, conditional sales, finance and operating leases, retention of title

arrangements and securitisation. An online searchable Personal Property Security Register is anticipated to go live when the PPSA commences.

**International.** Australia has not ratified the Geneva Convention<sup>ix</sup> or signed the Cape Town Convention. Nevertheless, Australian financiers are recording international sales and securities on the International Register where the circumstances meet the requirements for the creation of an international interest within the meaning of the Cape Town Convention. In March 2008, and again on 22 November 2010, the Department of Infrastructure and Transport wrote to aviation and finance industry members seeking their views on the benefits and risks to Australia ratifying the Cape Town Convention.<sup>x</sup> The consultation period has closed and no further information has been released with the focus appearing to have shifted to the Personal Properties Securities reform.<sup>xi</sup> Interestingly, New Zealand has become a party to the Cape Town Convention and Aircraft Protocol and amended its domestic Civil Aviation legislation to bring the Convention and Protocol into force.

**Company Charge Register and Bills of Sale Legislation.** Until the PPSR commences, Australia does not have an aircraft-specific register for recording security interests in aircraft or their engines. The *Corporations Act 2001* (Cth) permits registration of “charges” over property of corporations registered under the Act by notification to the Australian Securities and Investments Commission (ASIC). “Charges” is defined widely and includes fixed charges and mortgages over specific assets such as airframes, engines and lease receivables, and floating charges over a company’s entire assets and undertaking. Typically a “fixed charge” does not involve an assignment of title in the aircraft to the security holder but a “mortgage” does until the security is paid out at which time title reverts back to the borrower.

Registration of a charge is advisable (and required) if advantage is to be taken of rules of priority against other creditor’s security and to avoid invalidation rules that apply to unregistered charges in the event of an administrator or liquidator being appointed to the chargor company. A release and discharge is effected by filing the applicable ASIC form, although, from a debtor’s perspective, it is also prudent to obtain a common law Deed of Release whereby the chargor acknowledges payment of the debt and discharge and release of the aircraft.

In addition to company “Charges”, it is possible to register a security interest by way of a bill of sale against aircraft and aircraft engines under certain bills of sale legislation in Australia. Currently there is a multitude of legislation and registers, with each State and Territory operating under its own regime. The level of security provided under these regimes is not particularly satisfactory for large-scale or medium-to-long-term equipment financing and is not as advantageous as a charge under the *Corporations Act 2001* (Cth).

**Legal Opinions.** Although the form differs depending on the requirements of the financier/lessor, it is not unusual for an opinion to be required to the effect that the purchaser or lessee of the aircraft is duly incorporated, has capacity and that the relevant documents have been duly executed, do not contravene any law of Australia and are binding and enforceable in Australia.

**Insolvency.** In the event that a lessee is placed in administration, a lessor/owner and a fixed charge holder cannot, without the consent of the administrator or the Court, repossess the aircraft unless steps to recover the aircraft have been commenced prior to the company going into administration. Within seven days of the commencement of the administration the administrator can give notice to the owner or lessor that the company does not propose to exercise rights in relation to the aircraft. If this does not occur, the administrator is personally liable for rent and other amounts payable under the agreement entitling the company to possession of the aircraft.

**De-Registration and Export.** For cancellation of registration to be effected by someone other than the registration holder, such as may occur where repossession has taken place, the CASA guidelines indicate a “letter of authority” on the aircraft registration holder’s company letterhead giving authority to sign the required form will be accepted. The “Cancellation of an Aircraft Registration” form (Form 026) provides for signature by the holder of a “letter of authority”.

It is unclear whether or not CASA will accept a financier’s signature under a de-registration power of attorney without a letter of authority. The Form 026 is structured so that only an office holder or letter of authority holder (but not an “attorney under power of attorney”) can sign to de-register an aircraft. Nevertheless, valid de-registration powers of attorney will generally be enforceable by Court action.

**Domestic Liens. Airservices Australia (AA),** a government authority established by the *Air Services Act 1995* (Cth), provides facilities and services relating to Australian terminals and airspace.<sup>xii</sup> These are charged to and incurred by aircraft on a per flight basis (along with levies AA collects for other authorities).<sup>xiii</sup> To assist in enforcement of payment, AA maintains a Register of Statutory Liens. If its charges are not paid, AA has power to impose a statutory lien on aircraft by making an entry in the Register. The lien operates in priority to other security interests (except “floating” charges) and prohibits removal of the aircraft from Australia.<sup>xiv</sup> AA has the power to seize aircraft until the outstanding amounts are paid or, where amounts are unpaid for nine months, the power to sell the aircraft “free of all encumbrances, leases and contracts of hire”. To determine if a lien exists, a certificate can be requested by the Registration Holder, the owner, and, at the discretion of AA, a party with a security interest. A security interest holder can request that AA record the interest on its “AvCharges Financial Interest Register”. In the event that a statutory lien is entered against the aircraft, AA is required to take reasonable steps to notify the aircraft owner, operator, lessee, hirer, charterer or pilot in command and, if a security interest holder is noted on the AvCharges register, that security holder.

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## Liability

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**Carriers’ Liability.** Liability to passengers for injury or death and baggage in connection with commercial carriage in or from Australia is governed by domestic legislation (*Civil Aviation (Carriers’ Liability) Act 1959* (Cth) and equivalent State/Territory Acts), which give effect to the Montreal Convention 1999, and also to the Warsaw Convention as amended by the Hague and Montreal Protocols No.3 and No.4, the Guadalajara Convention and the Montreal Convention 1999 (although their application is becoming less common). Liability to passengers and baggage does not extend to financiers whose involvement in aircraft is limited to funding and, as yet, in Australia there is no concept of liability of a financier (owner) for “negligent entrustment” of an aircraft.

**Surface Damage.** Under Commonwealth and State/Territory “Damage by Aircraft” legislation, damages for certain injury, loss, damage or destruction caused by aircraft or things falling from aircraft in flight, are recoverable without proof of fault. Joint and several recovery is possible against the aircraft operator and owner. An owner is excluded from liability under the legislation where the owner does not have an active role in the operation of the aircraft (such as a financier or lessor) and who has, by an arrangement, given another “exclusive right to use the aircraft”.

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## Tax and Duties

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**Classification of Leases.** The principles of classification in Australian accounting standards<sup>xv</sup> of leases as either “operating” or “finance” leases are largely adopted in Australian taxation law. Under a finance lease, substantially all of the risks and rewards incidental to ownership of the asset (but not necessarily title) transfer to the lessee. A lease that is

not a “finance lease” is an “operating lease”. A sale and leaseback may fall into one or other category depending upon its terms.

The tax consequences of a lease will differ depending on its classification. Generally, a resident owner/lessor is entitled to deductions for depreciation and a lessee will be entitled to deductions for rental payments for equipment used for income producing purposes. A resident lessee under a hire-purchase agreement, although not a legal owner until the purchase is consummated, is nevertheless entitled to deductions for the decline in value of the leased equipment.

**Good and Services Tax (GST).** This is the Australian equivalent of VAT and it replaced significant aspects of the sales tax regime that previously operated in Australia. The supply of an aircraft (by lease or by sale) in or to Australia is subject to GST (10%) unless the aircraft is exported within 60 days of its receipt or such extended period as the Commission of Taxation determines.

**Cross-border Leasing.** With leases of equipment such as aircraft in Australia by non-resident lessors who have no permanent establishment in Australia, the lease payments may be subject to withholding tax. The rate varies from 10% to 30% depending on whether or not there is a double tax agreement (DTA) between Australia and the country of residence of the lessor and its lessees. If an aircraft is leased to an Australian operator for a term of more than 12 months, the lessor (when there is a DTA and depending upon its terms) may be deemed to have a permanent establishment in Australia, with the result that withholding tax will not be payable but the lessor will be liable to pay income tax on the lease payments at the current company rate of 30%.

Non-resident lessors from the United States or the United Kingdom are not liable for royalty withholding tax under the relevant DTAs which omit payments for the use of equipment from the definition of “royalty”.

Provisions to indemnify non-residents for liability to pay royalty withholding tax in Australia may, depending upon the circumstances and the relevant DTA, be treated as a liability to pay a royalty which may itself attract additional withholding tax.

Where there is a financing element in a lease or purchase arrangement with a non-resident lender, interest withholding tax provisions may apply at a rate of 10%.

The resident taxpayer is required to remit withholding tax directly to the Australian Taxation Office (ATO) before an income tax deduction can be obtained.

**Stamp Duty.** In each State and Territory in Australia legislation imposes a liability to pay duty calculated on the consideration passing under certain “dutiable transactions” (whether or not the transaction is in writing). Relevantly, duty may apply to a sale and to security instruments if the aircraft is located in an Australian State or Territory. It is often possible to structure aircraft transactions to ensure no duty is payable.

## Contact

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<sup>i</sup> Section 20AA, unless the aircraft is exempt under the limited categories in the *Civil Aviation Safety Regulations* 1998 (Cth): Reg. 47.015.

<sup>ii</sup> Civil Aviation Safety Authority Home Page – <http://www.casa.gov.au>

<sup>iii</sup> *Civil Aviation Regulations* 1988 (Cth): Regs. 39 and 41, CASR 202.222

<sup>iv</sup> See Regulation 206 of the *Civil Aviation Regulations* 1988 (Cth).

<sup>v</sup> Operational Specifications. The AOC and Ops Spec form adopts the specification set out in Annex 6 to the Convention on International Civil Aviation.

<sup>vi</sup> *Personal Property Securities Act 2009* (Cth) section 12(1).

<sup>vii</sup> [www.ag.gov.au/pps](http://www.ag.gov.au/pps)

<sup>viii</sup> Convention on International Interests in Mobile Equipment and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment both signed in Cape Town, South Africa on 16 November 2001

<sup>ix</sup> The Convention on the International Recognition of Rights in Aircraft, signed at Geneva, Switzerland, on 19th June 1948.

<sup>x</sup> [http://www.infrastructure.gov.au/aviation/international/pdf/2010\\_Consultation\\_Paper.pdf](http://www.infrastructure.gov.au/aviation/international/pdf/2010_Consultation_Paper.pdf)

<sup>xi</sup> See: [http://www.infrastructure.gov.au/aviation/international/consultation\\_cape\\_town.aspx](http://www.infrastructure.gov.au/aviation/international/consultation_cape_town.aspx)

<sup>xii</sup> Terminal navigation, aviation rescue and fire fighting and enroute.

<sup>xiii</sup> The meteorological services charge for the Bureau of Meteorology and a noise levy for the Department of Infrastructure and Transport.

<sup>xiv</sup> A penalty of up to three years imprisonment can apply for unlawful removal of the aircraft.

<sup>xv</sup> See Australian accounting standard AASB117. Note that the AASB117 is currently under consideration for replacement (ED202R Leases).