

TAX MATTERS

A newsletter dedicated to informing California Aircraft and Vessel owners about taxes

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THE CAPE TOWN CONVENTION AND THE INTERNATIONAL REGISTRY

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I've been involved in the delivery of aircraft for nearly 30 years. Collectively, attorneys in our firm have been involved in the purchase, sale or delivery of over 1,500 commercial and business aircraft. Closing these transactions has been a fairly simple process, and one that we are all very familiar with, whether it is an international transaction involving a foreign registry or a domestic transaction involving only the FAA Registry. Perhaps the 'world record' fastest closing occurred in 1984, when I participated in the delivery of a British Airways 757 (G-BIKL) that closed in 7 minutes from start to finish. Unfortunately, as of March 1, 2006, there is virtually no chance that this record will ever be broken. The days of quick aircraft closings are probably over.

March 1st brings the first major change to the aircraft sale and delivery process since the invention of the over-water delivery. March 1st marks the establishment of an International Registry for Aircraft in Dublin, Ireland. This International Registry was created pursuant to an international treaty -- the "Convention on International Interests in Mobile Equipment," the corresponding "Protocol to the Convention on Matters Specific to Aircraft Equipment," and related regulations. Let's just call it "Cape Town," in recognition of the city where it was created.

Here's what we know so far:

- As of March 1, 2006, Cape Town is in full force and effect.

- Cape Town establishes an International Registry to register "interests" in aircraft. Interests include outright ownership, and such agreements as aircraft leases, security interests, mortgages and conditional sales.

- Cape Town is not going away.

- If an aircraft is registered or will be registered in the United States or any other Cape Town contracting state or if the Debtor (including Seller or Lessee) is situated in a Cape Town contracting state, a filing should be made at the International Registry (a) when an aircraft is purchased or sold or (b) when a lease or security interest becomes effective.

- The Cape Town contracting states — as of today are:

- United States
- Ethiopia
- Ireland
- Malaysia
- Nigeria
- Oman
- Panama
- Pakistan
- Senegal

Promoters are hopeful to add more countries over time. The most optimistic predict 40-50 countries, but they don't speculate as to timing. It took 12 years to get this far.

- If you have a transaction involving a U.S.-registered aircraft, you will still deal with the FAA Registry in Oklahoma City -- just like you always have. The FAA is considered an “entry point” to the International Registry, and if you fill out the applicable form (AC Form 8050-135) the FAA will issue you a code number corresponding to your filing time which you can then use to make the required filing at the International Registry.

- The International Registry is an internet-based electronic system established in Ireland. Both Buyer and Seller (or Debtor and Creditor) will have to be “registered users” on the system and/or appoint a “professional user entity” in order to make filings and provide the consents required by the International Registry. This will mean additional ministerial costs and up-front planning by Buyers, Sellers, Debtors and Creditors on each and every transaction.

- Parties will need to perform (and pay for) multiple searches of the International Registry to determine who may have an interest in the aircraft throughout the process.

- Filings and searches can be done 24 hours a day, 7 days a week online in cyberspace. However, certain time limits will apply - if you don't make filings within the required time limits, you get to start over and pay additional fees.

- Creditors will likely ask Debtors to sign a special power of attorney—called an “Irrevocable De-Registration and Export Request Authorization” -- which will allow the Creditor to make a speedy escape with the collateral following a repossession.

- Cape Town doesn't apply to all aircraft; but suffice it to say that all aircraft, helicopters and engines that we deal with will be included. (Ask someone if it doesn't apply -- only if your aircraft has less than 8 seats including crew seats.)

- Transactions that closed prior to March 1, 2006 should require no further action; however a contracting state may elect to make the system retroactive. Fortunately, the United States did not elect to do this.

- Even if the Aircraft is not registered in a Cape Town contracting state, you will still need to spend

some time determining if a Seller or the Debtor is deemed to be situated in a Cape Town contracting state. For an individual, this is determined by where he or she “habitually resides.” For a company, this is determined by where it is incorporated, or has its principal place of business or center of administration.

Aviation attorneys, the major title and escrow companies and FAA special counsel in Oklahoma City are quickly getting up to speed on the process of filing with the International Registry; however, expect confusion and be prepared to accept delays until everyone becomes familiar with the procedures being developed in Ireland. The system opened March 1, 2006, but it has not been adequately tested. Mistakes will be made. New law will be written.

The beneficiaries of this new system, if any, will be lenders and lessors of aircraft that desire to provide capital to countries that do not have established and consistent aircraft registries and lender-favorable bankruptcy and repossession laws. Manufacturers that wish to sell aircraft into these less-developed countries may also benefit, indirectly, due to increases in available capital.

On the other hand, Cape Town adds an additional layer of bureaucracy and additional costs to the typical business-jet transaction, with no corresponding benefit to the parties. In addition, banks, lessors and manufacturers providing financing will be given expanded rights and remedies under Cape Town, even for transactions in the United States and other countries that already have well-established aircraft registries and legal systems. Some of these financing parties are even reported to be in discussions with each other on how to deny Buyers, Debtors and Lessees what rights and remedies they have under Cape Town. The fractional ownership programs are also unduly burdened. Like the lessors and manufacturers, some have elected not to allow their program participants to make the appropriate filings to acknowledge their ownership interest in the aircraft. Also, expect to see unscrupulous brokers and middlemen attempt to take advantage of some unintended consequences of some of the Cape Town provisions.

Personally, I'm not sold on the anticipated economic benefits of Cape Town cited by its proponents.

During the years I spent negotiating agreements for commercial aircraft sales in the Middle East and Africa (including in a number of Cape Town contracting states) the manufacturer's production constraints, the desire to sell to favored "large fleet" customers, and non-credit-related risks and considerations played a much greater role in determining whether a sale would be made than did the availability of capital or the developmental stage of the country's aircraft-registration or legal system. Government guarantees, manufacturer participation in the financing and start-up leasing companies -- that seemed to spring up overnight -- would get the deals done. The transactions that didn't go through probably shouldn't have. While Cape Town may help introduce traditional mechanisms of financing or leasing in less-developed countries, Cape Town does nothing to bring an end to the corruption, graft or plain-brown envelopes full of influence and persuasion that many times override economic common sense, ethics and the written law.

For those that want to know more about Cape Town, seminars and workshops regarding the details of the new system are being hosted by the International Registry and other interested parties. In addition, Contract Practices Under The Cape Town Convention (Uniform Law Foundation, 2004) — the so-called "Purple Book" — and The Official Commentary to the Convention on International Interests in Mobile Equipment and Protocol Thereto on Matters Specific to Aircraft Equipment (International Institute for the Unification of Private Law (UNIDROIT), 2002) -- the so-called "Yellow Book" -- are both must-have resources for practitioners; however, you will not find them on Amazon.com.

For now, relax, plan ahead, and understand that there may be some delays on your next aircraft closing. Be prepared to open your wallets to cover additional fees and expenses, and try to negotiate for flexibility in your aircraft purchase agreement or financing documents that allows all parties fair treatment and the ability to react to the changes brought about by the new registration system under Cape Town. Please contact us if you have any questions.

Aero Law Group's practice includes the representation of over 200 clients on five continents, including emerging and established commercial airlines, emerging-growth companies focusing on aviation, some of the nation's largest investment banks and most prominent investment bankers in their aircraft and airline investments, and Fortune 500 Companies and high-net-worth individuals in domestic and international transactions involving the sale, lease, exchange and financing of commercial and business aircraft. Founded in 2000, our four attorneys currently practice full-time in the area of aviation law. Those attorneys have over 40 years of experience in aviation transactions and over 35 years of experience in tax issues and tax structuring. Aero Law Group recently completed transactions with Airbus Industries, for the acquisition of 20 A350 Aircraft as part of the merger activities of U.S. Airways and America West Airlines; with Boeing, for the acquisition of a number of 737-800 Aircraft for a major U.S. leasing company; and with a major completion and maintenance center, for the \$150 Million refurbishment of a VIP 747.

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