



A Call to Incentivize Business Jets to be Based in Russia

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Many Russian owners would gladly base their aircraft in Russia if the economics worked. This is a true statement, based on statements made by our clients and the talk in the Russian business aviation community.

1. What Russian Aircraft Owners Want

Russian owners of aircraft would like their aircraft to be immediately available to them at a nearby airport without having to be flown in from a foreign country. Russian owners would like to have Russian pilots fly their aircraft, and would like an adequate number of Russian pilots to be trained. Russian owners would like to be able to charter their aircraft for use inside Russia without having to assume the substantial risks and costs involved in flying foreign-registered aircraft in Russia. Russian owners do not want to have to pay bribes to fly their aircraft inside Russia, yet that is what today's system promotes. Russian owners do not want to have to struggle to get themselves included in a special list of persons who are exempted from generally applicable prohibitions on flying foreign-registered aircraft within Russia. Russian owners would like to be able to use their aircraft entirely legally within Russia for personal and commercial purposes. Russian owners want to allow their aircraft to be chartered by Russian and foreign businesses which would like to fly their officers within Russia (corporate officers who are here to consider new investments in the Russian economy), on fully-legal flights on modern, Russian-owned aircraft that are made available for charter inside Russia. Russian owners do not want to pay, and can not afford to pay, unreasonably high import VAT that has no parallel elsewhere in the world in order to bring their aircraft to Russia. Russian owners do not want to pay, and cannot afford to pay, monopolistically high prices to base their aircraft at one of the few fixed base operators which has acquired monopolistic control at Moscow and other airports.

2. The Undesirable Signal Sent to Foreign Investors by the Current Situation

Today, Russian business aviation is just another sector of the Russian economy that has been largely exported from Russia, and most all transactions in this sector are conducted outside of Russia. The legal, tax and regulatory environment is not conducive to own valuable assets in this industry in Russia.

This is part of the phenomenon of Russian persons exporting themselves and their assets and property out of Russia and turning themselves into foreigners who do not have to really care what happens at home in Russia, as long as there is "order" of some sort at home in Russia.

If Russia is going to modernize, as is desired on the highest political levels, then, it would follow that Russia should first reach for the low hanging fruit, its own people. Russia should create the right incentives to bring to Russia as many as possible of different Russian owned assets and capital, including business jets, that are today, intentionally, kept out of Russia by Russians. For not only are Russian owned assets being kept out of Russia, but foreign investors look at what Russians are doing. They believe that, if Russians are going to great lengths to get and keep their assets outside of Russia, then this must be a clear signal to foreign investors to do likewise and keep their assets outside of Russia and invest somewhere else.

At the present time, it is believed that approximately 450 business jets are owned directly or indirectly by Russian businesses and individuals. Of this number only approximately 30 are registered here in Russia. At Russian aviation conferences, it is commonly said by senior aviation officials that this state of affairs is an embarrassment for Russia. These statistics are a clear statement to independent observers that something is wrong in Russia. Yet, that something may be identified and fixed, if the will is there to do so.

3. The Huge Amounts of Productive Economic Activity That May Be Generated

Before turning to the technicalities of a proposal for what needs to be done to create the right environment for Russian owners to base their aircraft in Russia, let's consider a table showing what the positive economic impact for Russia may be, assuming that 400 additional Russian owned businesses were based in Russia. The positive economic impact for Russia of incentivizing owners of 400 Russian owned aircraft to base their aircraft in Russia would be huge.

		Number of New Jobs	Investment Required over 10 years
Employment directly related to aircraft	Russian Pilots (3 per aircraft)	1200 new	Training costs, and costs to retain qualifications, at \$150,000 per pilot
	Russian Engineers (2 per aircraft)	800 new	Training costs, and costs to retain qualifications, at \$30,000 per person
	Russian Cabin Crew (2 per aircraft)	800 new	Training costs at \$4,000 per person
	Flight Training Personnel	50 new	
	Fixed Base Operator Personnel	If 20 airfields, then 20 projects, employing 400 persons	

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Infrastructure	Former military airfields acquired and converted to business aviation. Construction of additional FBO's in existing airports.	20 new airfields across Russia, with multiple airports around Moscow, and one per each city of a million persons	Substantial privatization proceeds for the Russian federal government or military
	Reconstructing military airports into business aviation gateways with VIP passenger terminals.	If 20 airports, then 20 projects creating 100 employment positions each	US\$25 million for each project.
	Construction of new hangars.	For every 20 aircraft, 5 hangars would be required at 20 airports. Each hangar would employ 20 persons. Cumulatively, this would be 100 new hangars employing 2,000 persons	US\$20 million each on average
	Apron enhancements, utilities and runway work	If 20 airfields, then 20 projects, employing 500 persons	US\$20 million each on average
	fuel depots	1 per airfield, employing 100 persons	US\$5 million each on average
	certified aircraft maintenance facilities	1 per airfield, employing 200 persons	US\$20 million each on average
Community Impact			
	surrounding hotels	20 new hotels, employing 1,000 persons	US\$20 million each on average
	surrounding restaurants	100 new restaurants, employing 2,000 persons	US\$1 million each on average
	aircraft catering businesses	2 per airfield, employing 50 persons	US\$1 million each on average
	insurance companies	400 additional high value policies	
	consultants on airport master plans	If 20 airfields, then 20 projects, employing 100 persons	
	entertainment and recreation development near to airports	If 20 airfields, then 20 projects, employing 400 persons	
	large-scale corporate office development	If 20 airfields, then 20 projects, employing 400 persons	

Additional Workload for Rosaviatisia	aircraft registrations, inspections and certification of different aspects of aircraft usage		Assume \$30,000 in annual fees per aircraft
Additional Workload for Customs Service	Passenger and Cargo processing		Assume \$10,000 in various fees per aircraft
Total		Approximately 10,000 permanent jobs, the majority of which would be high-paying	Approximately \$4.5 to \$5 billion to be invested

The foregoing first approximation of the economic activity required to support 400 business jets based in Russia shows that the potential economic and tax impacts to airport stakeholders and the budgets of Russia's regions is huge. There would be many investment agreements concluded with Russian regional governments concerning investments to be made at each major Russian city.

4. Why do Russian Aircraft Owners Presently Not Base Their Aircraft in Russia?

The reasons why Russian owned aircraft are not based in Russia are multiple, but are primarily economic. The primary economic problems are two, import VAT and monopolization of existing airports used for business aviation.

Russian import VAT makes it not viable for most Russian owners of new and expensive business aircraft to import their aircraft to Russia. Large Russian enterprises that generate significant VAT receipts may recover import VAT. But, other Russian businesses and wealthy individuals who cannot offset and recover import VAT come to the conclusion that they just cannot afford to pay this tax.

As a simple example, a new Challenger 605 aircraft costs \$25,000,000. If a Russian purchaser of such an aircraft were considering letting his aircraft be used on charter flights to help offset the cost of ownership, then he would need to make a choice whether to lease the aircraft to an operator in Europe, or potentially here in Russia, and where the aircraft would be primarily based.

An owner considering allowing his aircraft to be used on charter flights may typically plan for the aircraft to be used for 500 hours of flights a year, with 200 hours to be the owner's usage, and 300 hours to be charter usage. The charter usage for this model of aircraft may cost EUR 6,500 per hour. The owner's usage shall be charged at the cost of operation, fuel, pilots, airport fees, provisions, etc. Money is earned from charter customers, not the owner. 300 hours of charter usage at EUR 6,500 would bring EUR 1,950,000 per year. If the aircraft is customs cleared in Russia, which is a prerequisite to putting it on a Russian operator's certificate, then the import VAT of 18% could be paid over 34 months. This would cost \$1,588,000 per year (\$25,000,000 x 0.18, divided by 34, multiplied by 12). This import VAT expense is a very large percentage of all foreseeable charter revenue, and makes the decision an unattractive one for the owner. Today, the owner would more likely decide to lease the aircraft to a European operator and fly the aircraft into Russia and within Russia using one-time permits for domestic flights of his foreign-registered aircraft.

It goes without saying that a Russian owner would only consider importing an aircraft to Russia that is exempt from customs duties. Today, no import duties are due for aircraft weighing less than 20,000

kg., but "only" import VAT is due to be paid, and, as discussed, this import VAT is enough itself to kill the golden goose.

If it were not bad enough that the import VAT would consume the majority of revenue from charter operations for an aircraft based in Russia, then monopolistically high fees at Russia's few business airports would consume the rest of foreseeable charter revenue and presently make it illogical to base an aircraft here in Russia. Moscow's business airports each have a single fixed base operator which is charging prices much higher than in European airports, as one is taught in a high school micro-economics class monopolists may charge when there is only one provider of a good or service.

5. How, Legally, May Russian Aircraft Be Based in Russia?

In order for an 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 this foreign-registered aircraft must be placed on to the certificate of a Russian operator. There are only seven countries outside of the former Soviet Union with which Russia has 83-bis Agreements. These are: (1) Ireland, (2) Turkey, (3) Switzerland, (4) Bermuda, (5) Austria, (6) Bulgaria, and (7) Malawi.

There are other countries where Russians commonly register aircraft, but aircraft registered in these countries will not be eligible to be placed on a Russian AOC. Examples of other countries that do not have 83-bis Agreements with Russia include: in tax-haven jurisdictions - the Bahamas, and the Cayman Islands; and in Europe - the UK, Isle of Man, Finland, Germany, Malta, and Portugal.

The amount of time to register an aircraft in any one of these jurisdictions will be between 4 and 8 weeks. Another potentially time consuming issue is the requirement that a technical inspector needs to inspect the aircraft before it can be taken on the registry in one of these seven countries.

Depending on the intended geographic use of the aircraft, Switzerland offers the possibility to register an aircraft privately, without importation of such aircraft into Switzerland. Outside of Switzerland this will allow for unrestricted operation of the aircraft, however certain limitations apply to flight from and to Switzerland.

To place an aircraft on a Russian AOC's certificate, the Aircraft must be type certified in Russia and have a Russian airworthiness certificate. Some aircraft are type-certified in Russia, but the procedure to get airworthiness certificate must still be completed.

There are a number of nuances about permitted use of foreign registered aircraft to fly passengers within Russia as part of an international flight. And there are a number of points to be made about permitted use of an aircraft in the interests of the aircraft owner. And then there are a lot of practices and interpretations that one hears as rationalizations for aspects of grey aviation in Russia. These polemics are outside the scope of this article, except to say that there are significant risks for owners of aircraft engaged in grey aviation, and Russian owners would prefer not to be compelled by the economic consequences of import VAT and high costs in Russia to consider less than fully legal operation of their aircraft on commercial flights inside Russia.

6. A Tax Proposal to Incentivize Russian Aircraft to be Based in Russia

The Russian government should consider exempting aircraft that are placed on the certificate of a Russian operator from import VAT. The main argument in support of this proposal is that the Russian government is, today, receiving zero import VAT with regard to the approximately 420 business jets owned by Russian businesses that are presently being kept outside of Russia specifically in order not to trigger an obligation to pay import VAT on these aircraft. The Russian government may agree to receive the same zero amount of import VAT with regard to these 420 aircraft, and yet, by allowing these business jets to be based in Russia without payment of import VAT create 10,000 new jobs, and up to \$5 billion of investment.

In order to make sure it is not misled in giving this exemption from import VAT for aircraft based in Russia, the Russian government may add a few collateral requirements to establish that an aircraft is actually based in Russia. These requirements may include the location of the aircraft when not in service, the employment of Russian crew, the existence of payments under a lease agreement with a Russian operator and payments under a hangar lease agreement. These tests would substantiate that Russia is getting the economic benefit of employment and investment related to these aircraft.

The timing is, perhaps, very attractive for Russia to lower its import VAT for business jets since there has been a recent VAT rule change in Europe. As of January 1, 2011, a business jet may only qualify for an exemption from British import VAT if the aircraft is to be used by an airline. Previously, a business aircraft could be imported to the European Union with a zero percent VAT rate by means of registering the aircraft in the UK. Now, owners of business aircraft will be seeking new jurisdictions in Europe that offer low import VAT rates. Russia may compete to attract aircraft registrations by offering a VAT rate for business aircraft of zero percent, or a very low percentage that is no higher than the lowest rate offered by any European country.

Russia may consider replacing its potential import VAT revenue that it is not in fact receiving with a different tax that can be more definitely collected and the proceeds of which may be applied to benefit the aviation industry. For example, the US does not have VAT, but it does have an "aviation fuel tax". Jet fuel is taxed at 21.9 cents per gallon unless it is used for commercial aviation in which case a much lower tax of 4.4 cents per gallon is due. The US aviation fuel tax is used to fund airport and air traffic control operations by the [Federal Aviation Administration](#).

To address the issue of monopolization of the limited number of airports in Russia suitable for business aviation, there seem to be two approaches. One is to require that, at each airport which services business aviation, there may not be only a single FBO, and there must be at least two, if a second or third group desires to provide services. Second, there should be more airfields made available for business aviation, and it seems the most likely source of new airfields is to reconstruct existing surplus military airfields.

A third device to assure that Russia gets the economic benefit of business aviation and investment in aviation facilities and related business across Russia would be for the Russian government to clamp down on grey aviation in Russia and to become strict about not allowing foreign registered aircraft to be used on domestic commercial flights unless the aircraft are on a Russian operator's certificate.

In sum, there are potentially huge economic benefits for Russia if it sets out to create the right economic environment for Russian owners of business aircraft to base their aircraft in Russia and have their aircraft operated by Russian operators. If the Russian government takes the necessary decisions to incentivize existing Russian-owned business jets to be based in Russia, it will create many thousands of new jobs for highly trained Russian citizens, and it will likely trigger several billions of dollars of investment activity that will help to modernize the Russian economy.

