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AVIATION INDUSTRY IN INDIA

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Table of contents

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Overview

Aviation in India, broadly divided into military and civil aviation, is the fastest-growing aviation market in the world, according to the International Air Transport Association ("IATA"). The hub of the nation's aviation manufacturing industry is at Bangalore, which has a 65% share of the economic sector since 1924. The civil aviation industry in India has emerged as one of the fastest-growing industries in the country during the last three years and can be broadly classified into three categories: scheduled air transport service, which includes domestic and international airlines; non-scheduled air transport service, which consists of charter operators and air taxi operators; and air cargo service, which includes air transportation of cargo and mail. Domestic traffic contributes around 69% of the total airline traffic in South Asia, and India's airport capacity is expected to handle 1 billion trips annually by 2023.

Just after independence, India had nine air transport companies transporting both cargo and passenger traffic. In 1953, the Indian government nationalized all the existing airline assets. Indian Airlines was set up to cater to the domestic market, while Air India was set up to take care of the international sector. Both Indian Airlines and Air India enjoyed monopolies over the Indian skies.

The Indian aviation industry has recovered fully from the COVID-19 pandemic shock, as indicated by the air traffic movement, which stood at 613,566 in the first quarter of FY 2022–23 compared to 300,405 in the same period last year, an increase of 104.24%. India is currently the 7th largest civil aviation market in the world and is expected to become the third-largest civil aviation market within the next 10 years. India has become the third largest domestic aviation market in the world and is expected to overtake the United Kingdom to become the third largest air passenger market by 2024.

India's aviation industry is largely untapped and offers huge growth opportunities, considering that air transport is still expensive for the majority of the country's population, of which nearly 40% is the upwardly mobile middle class.

Current scenario

Currently, major airlines connect 103 operational airports within the country and many more across the globe. Despite the Regional Connectivity Scheme (RCS)-Udan, India's aviation industry is largely untapped and offers huge growth opportunities. The Indian government is planning to invest $1.83 billion for the development of airport infrastructure along with aviation navigation services by 2026.

In FY22, the number of aircraft movements stood at 1,757,112, and aircraft movements reached 1,207,279 in FY 2022–23 (April–September 2022). The Indian aviation industry is expected to grow 5.3 times by 2033.As per IATA, India is forecasted to gain an additional 359 million passengers by 2037, compared to 2017.

The aviation industry in India is expected to grow six times by FY40, according to a report released by the Federation of Indian Chambers of Commerce and Industry ("FICCI"), with passenger traffic (to, from, and within India) expected to reach 1.1 billion, up from 187 million in FY18.

IATA expects air passenger numbers to, from, and within India to increase by 3.3 times over the next 20 years, to more than 500 million passenger journeys per year. This strong growth outlook for air passenger demand will see India overtake Germany, Japan, Spain, and the United Kingdom within the next 10 years to become the world's third-largest air passenger market.

Total freight traffic for the same period was two million tons. Airlines in India spend about 13 to 15 percent of their revenues on maintenance, the second-highest cost item for airlines after fuel. Generally, airlines carry on-tarmac inspections (A and B checks) in-house and work with third-party Maintenance, Repair, and Overhaul (MRO) for engine, heavy maintenance (C and D checks), and modifications.

Government initiatives

- The Regional Connectivity Scheme ("RCS") UDAN scheme has been allocated Rs. 601 crore (US$ 77.52 million) to stimulate regional air connectivity.

- For a better execution of the PM-Gati Shakti vision, the minister of civil aviation asks for synergy between the central and state governments to build 16 new airports in Madhya Pradesh, Chhattisgarh, Uttar Pradesh, Rajasthan, and Maharashtra.

- The Ministry of Civil Aviation launched the Krishi UDAN 2.0 scheme in October 2021. The scheme proposes assistance and incentives for agricultural product transportation by air.The Krishi UDAN 2.0 will be implemented at 53 airports across the country, largely focusing on the northeast and tribal regions, and is expected to benefit farmers, freight forwarders, and airlines.

- Foreign direct investment in air transport services (ATS) has gone from 40 percent to 49 percent in the case of M/s Air India.

- Private service providers with five years' experience in the domestic sector and a fleet size of twenty aircraft were given licences to operate on international routes. Jet Airways has started operating to international destinations.

Foreign investment

According to the data released by the Department for Promotion of Industry and Internal Trade ("DPIIT"), FDI inflow in India's air transport sector (including air freight) reached US$ 3.61 billion between April 2000-September 2022. The government has allowed 100% FDI under the automatic route in scheduled air transport service, regional air transport service, and domestic scheduled passenger airlines. However, FDI over 49% would require government approval.

The number of PPP airports is likely to increase from five in 2014 to 24 in 2024. India's aviation industry is expected to witness Rs. 35,000 crores (US$ 4.99 billion) investment in the next four years. The Indian Government is planning to invest US$ 1.83 billion for the development of airport infrastructure along with aviation navigation services by 2026.

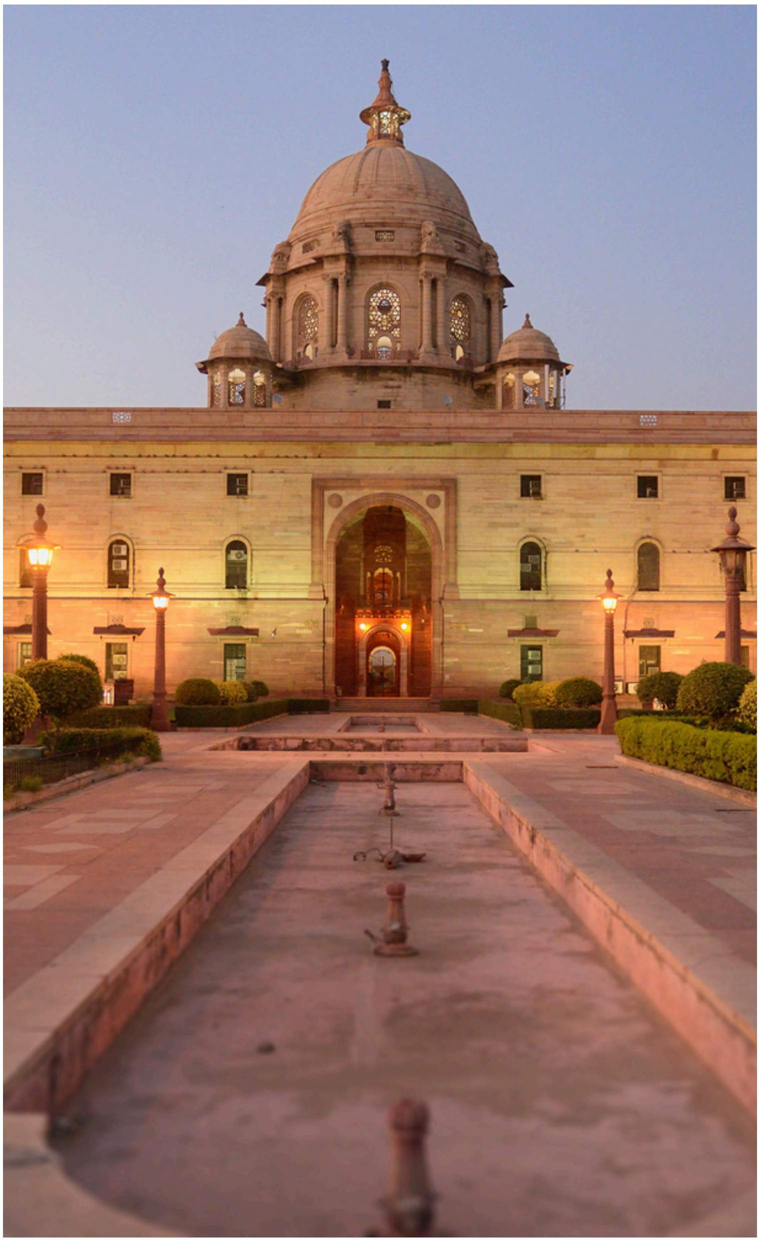
India aims to have 220 new airports by 2025, said, Mr. Jyotiraditya Scindia, Minister of Civil Aviation. Cargo flights for perishable food items will also be increased to 30% with 133 new flights in the coming years. In 2022, Mumbai International Airport Ltd ("MIAL") raised US$ 750 million in debt in a private placement from a US-based private asset manager, Apollo Global.

Adani Airport Holdings ("AAHL") raised US$ 250 million in May 2022 for capital expenditure and for the development of six airports that it currently manages. In February 2022, the Airports Authority of India ("AAI") and other airport developers set a capital outlay target of Rs. 91,000 crores (US$ 12.08 billion) for the development of the airport industry.

Laws in the industry

The Aircraft Act, 1934, and the Aircraft Rules, 1937, regulate the manufacture, possession, sale, use, operation, export, and import of aircraft. Among other things, they also stipulate the parameters pertaining to:

- airworthiness;
- aircraft maintenance;
- general conditions of flying and safety;
- the registration of aircraft; and
- the conduct of investigations.



The Airports Authority Act, 1994, established the Airports Authority of India ("AAI"). The AAI is responsible for the development, finance, operation and maintenance of all government airports in India.

The civil aviation requirements are issued by the Directorate General of Civil Aviation ("DGCA") and set out, among other things, the various requirements to be fulfilled by stakeholders before the issuance of a license, certificate, approval, or permission.

The Carriage by Air Act, 1972, governs the rights and liabilities of carriers, passengers, consignors, consignees, and other persons, and applies to both domestic and international carriage by air.

The Airports Economic Regulatory Authority of India Act, 2008, established the Airports Economic Regulatory Authority of India ("AERA"). The AERA is responsible for the regulation of tariffs and charges for the various services rendered by airports in India.

Other relevant legislation relating to the civil aviation sector includes the following:

- the Tokyo Convention Act, 1975;
- the Suppression of Unlawful Acts Against Civil Aviation Safety Act of 1982;
- the Anti-Hijacking Act, 2016;
- the Aircraft (Public Health) Rules, 1954;
- the Aircraft (Demolition of Obstruction Caused by Buildings, Trees, etc.) Rules, 1994;
- the Aircraft (Carriage of Dangerous Goods) Rules, 2003; and
- the Aircraft (Investigation of Accidents and Incidents) Rules 2017.

The directorate general of civil aviation is the principal regulatory body that primarily governs civil aviation in India. It is responsible for dealing with safety issues, the regulation of air transport services, the enforcement of civil air rules and regulations, and other such tasks. It also coordinates its functioning with the International Civil Aviation Organization ("ICAO"). One of the main tasks of this body is to ensure air safety and airworthiness standards.

The Ministry of Civil Aviation "MoCA" is responsible for formulating national policies and programmes for the development and regulation of the civil aviation sector in India. The MoCA also enforces the applicable laws and regulations pertaining to the civil aviation sector by exercising administrative control over attached and autonomous organizations.

Licensing and support

In order to operate air transport services, an operator must apply for, and be granted after due diligence by the Directorate General of Civil Aviation ("DGCA"), an Air Operator Permit ("AOP"). This permit is equivalent to the air operator certificate that must be issued by a member state of the international civil aviation organization. The type of license applied will depend on the type of air transport service offered by the operator, and not the routes it intends to operate.

An AOP is granted for the following types of air transport services:

- scheduled air transport services;
- non-scheduled air transport services;
- air transport cargo services; and
- scheduled commuter air transport services.

An AOP for scheduled or non-scheduled air transport services may be granted to the following parties:

- a citizen of India; or
- a company or a body corporate, provided that:
  1. it is registered and has its principal place of business within India;
  2. its chairman and at least two-thirds of its directors are citizens of India; and
  3. its substantial ownership and effective control are vested in Indian nationals.

An AOP for air transport cargo services may be granted to the following parties:

- a citizen of India;
- a group of individuals of Indian nationality or a trust/society registered under the Societies Registration Act, 1860;
- a non-resident Indian (NRI)/overseas corporate body;
- a company registered under the Companies Act, 2013 which has its principal place of business in India, and with or without equity participation (excluding NRI equity) as approved by the government from time to time; or
- the central government, a state government or an undertaking owned or controlled by any of those governments.

Procedure to obtain license

The CAP 3100 Air Operator Certification Manual details the various requirements that an operator must fulfil in order to obtain an AOP. The entire process has been classified and divided into different phases as follows:

- **Pre-application phase:** The operator submits to the Ministry of Civil Aviation (MoCA) a letter of intent outlining its proposal and applies to the MoCA for the issuance of a no-objection certificate (NOC). The certificate is issued upon the examination of the proposal from financial, economic, and legal perspectives.

- **Formal application:** The operator submits a complete application in the prescribed form to the DGCA, along with the prescribed fees and all supporting documents. After conducting due diligence, the DGCA may invite the operator to a meeting to discuss the application.

- **Document evaluation:** During this phase, the DGCA assesses the applicant's capability to conduct aircraft transport operations by verifying the various documents submitted. The documents must precisely reflect the mode and the methods through which the applicant intends to conduct the proposed operations. Upon approval, these will form part of the understanding between the DGCA and the operator regarding the future functioning of the operator.

- **Demonstration and inspection:** During this phase, the applicant must demonstrate to the DGCA its capability to conduct the proposed operations in accordance with the procedures detailed in the manuals and documents reviewed in the previous phase.

- **Certification:** Upon fulfilment of the criteria stipulated by the DGCA and successful completion of the procedures detailed in the above phases, the DGCA will issue an AOP.

Taxes and exemptions

The introduction of Goods and Service Tax ("GST") law has increased the compliance cost applicable to the airline company. Airlines are required to register in every state in which they provide service and are presently still grappling with aligning the global distribution systems to keep up with the evolving law. To smoothen the process, the government has provided numerous favorable measures such as exempting GST on inter-state movement of aircrafts, reduced rate for lease premiums. Requirement to reverse ITC, added cost of inputs due to ATF kept outside the ambit of GST is posing considerable hardships on the industry.

The rate of GST on flight tickets: Economy Class: 5% GST and Business Class: 12% GST

Goods and Services Tax ("GST") rate has been reduced from 18% to 5% for domestic Maintenance, Repair and Overhaul ("MRO") services.

Impact of Goods and Service Tax -

Increased rate of tax

Air travel is currently subject to lower service tax rates on account of the relaxation offered in the form of abatements on the value of airfares. The current service tax rate is effectively 6% for economy air tickets (after an abatement of 60% of the value of services) and 9% for non-economy tickets (after an abatement of 40% of the value of services). With the GST rate likely to be 18%–20%, the cost of air travel will consequently increase. Though cross credits will be available, these would be insubstantial for a sector that has minimal consumption of goods, other than aviation turbine fuel.

Place of supply for air travel

The model GST law stipulates guidelines to determine the place where supplies will be taxed. Detailed provisions that determine the place of supply of goods and services are also provided. Under the current indirect tax regime, international air travel is subject to service tax on the ticket fare for both the outward and return leg, (less applicable abatements), so long as the air travel commences in India. However, air travel commencing outside India is not subject to service tax. Under the model GST Law, air travel commencing outside India will now be subject to GST in India, if provided to customers registered under the GST.

GST applicable to cross-border leasing of aircraft

Carriers worldwide are increasingly operating their fleets on a lease model, with aircraft leased from specialist leasing companies. This option is preferred for a wide range of economic benefits. Lease agreements executed in India, are currently subject to Value Added Tax ("VAT"). To avoid this levy, carriers enter into aircraft leasing arrangements outside India.

Impact on Maintenance, Repair, and Overhaul ("MRO") Services:

MRO services involve the transfer of both goods and services and qualify as "works contracts," subject to both VAT and service tax. VAT levied by MRO service providers is a cost for aircraft carriers, as VAT cannot be set off against service tax. To avoid VAT, most carriers opt to avail of MRO services outside India. The model GST law specifies that work-contract transactions are deemed to be services. Furthermore, when carriers operating in India use MRO services, whether in India or elsewhere, the services are considered to be supplied in India and are subject to GST.

Increased compliance costs: Under the existing tax regime, carriers are only required to take a single service tax registration. The Model GST law prescribes registration in each State where a carrier undertakes a supply. Carriers will thus have to register in every state where the registered passenger is located and also in each state from which their flights originate. Further, the carrier will also be required to upload onto the GST network, invoice-wise details of supplies made to registered persons.

Exemption to Small Scale Service Providers

In exercise of the powers conferred by sub-section (1) of section 93 of the Finance Act, 1994 (32 of 1994), the central government, on being satisfied that it is necessary for the public interest so to do, hereby exempts taxable services of aggregate value not exceeding ten lakh rupees in any financial year from the whole of the service tax leviable thereon under section 66 of the said Finance Act:

Provided that nothing contained in this notification shall apply to:

- taxable services provided by a person under a brand name or trade name, whether registered or not, of another person; or
- such value of taxable services in respect of which service tax shall be paid by such person and in such manner as specified under sub-section (2) of section 68 of the said Finance Act read with the Service Tax Rules, 1994.

Dispute resolution

After analyzing various cases and situations, it has been found that alternative dispute resolution methods do not always work out in aviation sector unless it is a labour dispute specifically. This is why the model of prioritization strategy seems pretty appropriate. It is useful for parties to negotiate over a number of issues or resources since they can try to create value and maximise benefits by making trade-offs between them. This is because the order of priority among these issues for one party may differ from that of the other, providing an opportunity for exchanges. When bargaining on the basis of interests, parties must:

- distinguish between positions and interests
- move from positions to interests
- list all the interests according to priority
- think of positions as only one of many solutions to the problem.

The civil aviation sector has the potential to become the cornerstone of efficient trade and commerce in India. However, dispute resolution involving players from the aviation industry is still at a very nascent stage in India, with very few disputes being addressed before courts. Most matters are resolved or settled by mutual negotiations or before relevant regulatory authorities, depending on the nature of the dispute. Moreover, there is a clear absence of specialized dispute settlement forums or agencies set up expressly for the purpose of adjudicating on civil aviation disputes.

The last few years have seen several repossessions (the vast majority of which have been with the cooperation of Indian operators), some reasonably high-profile regulatory tussles with the Directorate General of Civil Aviation (DGCA), and customs and service tax-related scrimmages with tax authorities.

Recently, the Ministry of Civil Aviation proposed the draft Protection and Enforcement of Interests in Aircraft Objects Bill, 2022. One of the various methods of conflict resolution in the aviation industry is the prioritization strategy. This method is typically used in cases of air traffic where the use of a specific path is in dispute. The special characteristic of this strategy is that it arrives at a decision after a study entirely based on figures. This is done by comparing the scores of the aircrafts in conflict. The scores assigned to each aircraft are determined by the aircraft's location in airspace. In the process of applying the prioritization strategy, the scores of the aircraft are compared, and the one with the highest score is given priority over the others.

Even after such implementation of negotiation procedures, with the application of the BATNA (Best Alternative to Negotiating Agreement), the prioritisation strategy or any possible alternative that seems better than the one on the negotiating table can be given effect.

BATNA is a concept of strategic negotiation wherein the negotiator analyses what alternatives are available instead of the negotiated agreement so that the negotiator can have an upper hand at the bidding table. More than law, BATNA is a principle of corporate or business negotiations. The option of BATNA can be taken up by the negotiating party when the terms of the negotiating agreement do not work out. Identifying the BATNA and understanding its benefits is extremely essential before entering into any form of negotiation.

One of the best examples of BATNA is Iberia's negotiations with Boeing where he cracked an agreement with Boeing while keeping Airbus also through its prior negotiations with resale price guarantees. Overall, it has become pertinent that alternative dispute resolution methods turn out to be successful in the aviation industry, especially with regards to competition. When it comes to the disputes faced by the consumers, the Director General of Civil Aviation has issued certain guidelines that aid in securing their rights, and the Consumer Protection Act also covers this area to a major extent.

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How we can help?

Civil aviation in India is one of the fastest growing industries, and India is poised to become the third largest air passenger market. Chandrawat and Partners assists clients with comprehensive legal services based on in its well established expertise and experience in aviation. We provide comprehensive legal services based on our extensive knowledge of the aviation industry.

We assist our clients with the following scope of work:

- aircraft and engine leases, including finance leases, operating leases, wet leases, and charters;
- advise on aviation industry contracts such as those with MROs, ground handlers, airports, and air navigation service providers;
- aircraft and engine sale agreements;
- aircraft and engine finance including bank debt, export credit-supported financing, tax-driven structures and bilateral aviation treaties;
- maintenance and ground handling agreements;
- aircraft registration and taxation and
- liability and insurance matters.

Our attorneys have enjoyed a long association with this industry and its continuous evolution. We have complete understanding of the industry's commercial environment, its structure and economics, as well as the relevant laws across the entire commercial spectrum, which enables us to respond proficiently, quickly and effectively. Thus, our firm can handle the largest and most complicated transactions pertaining to this sector.

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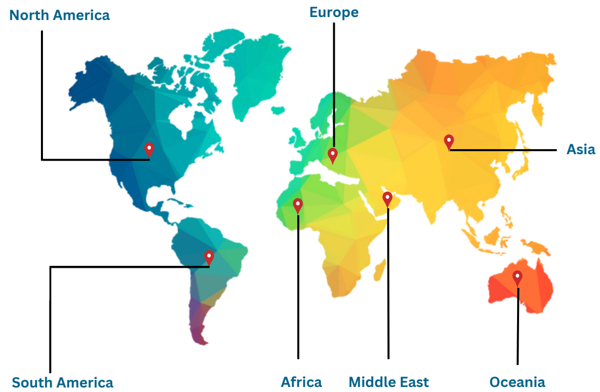

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