

LEGISLATIVE COUNCIL BRIEF

Inland Revenue Ordinance
(Chapter 112)

Inland Revenue (Amendment) (No.2) Bill 2017

INTRODUCTION

A At the meeting of the Executive Council on 28 February 2017, the Council **ADVISED** and the Chief Executive **ORDERED** that the Inland Revenue (Amendment) (No.2) Bill 2017 (the Bill) at **Annex A**, should be introduced into the Legislative Council (LegCo) to give profits tax concessions to qualifying aircraft lessors¹ and qualifying aircraft leasing managers², to make provisions for profits tax purposes regarding businesses in connection with aircraft, and to make consequential and minor textual amendments.

JUSTIFICATIONS

Aircraft financing is an attractive business to Hong Kong

Global trend

2. Civil aviation is a long-term growth business, with global aviation passengers expected to grow at about 5% per annum while passengers in the Asia Pacific region growing at about 6% per annum over the next 20 years³. The numbers of new aircraft delivered worldwide and in the Asia Pacific are estimated at over 39 000 (valued at about HK\$46.2 trillion or US\$5.9 trillion)

¹ Aircraft leasing is the leasing of aircraft to aircraft operators, where the lessee (aircraft operator) pays the lessor (owner of the aircraft) rental payments in order to operate the leased aircraft over an agreed fixed term. In practice, in the global aircraft leasing industry, a special purpose vehicle, which acts as the owner and lessor (usually a corporation), is normally used to hold an aircraft for leasing.

² Aircraft leasing manager is a separate legal entity which is remunerated by a management fee from the aircraft lessor for conducting activities incidental to aircraft leasing, such as evaluation of aircraft investment, fund raising, procurement of aircraft, soliciting leases, etc.

³ Source: *Current Market Outlook 2016-2035, World regions* published by Boeing Capital

and over 15 000 (valued at about HK\$18.3 trillion or US\$2.4 trillion) respectively⁴.

3. Financing this growth presents major business opportunities open for financial and other professional services to grasp. According to analysis conducted by the industry, the proportion of new aircraft being financed by leasing rose from less than 1% 40 years ago to about 32% in 2011. This proportion is expected to grow to about 40% by 2020⁵. Globally, demand for financing aircraft purchase is forecast to increase steadily at compound annual growth rate of about 6.7% between 2012 and 2019, with about HK\$952 billion (about US\$122 billion) financing requirement in 2016. Bank debts and capital market are the major sources of financing.⁶

Market opportunities in the Mainland

4. Under the global trend, there has been sizeable growth in aircraft demand by Mainland airlines, which in turn induces demand for aerospace financing. According to analysis conducted by the industry, from 2012 to 2032, Mainland airlines will need nearly 6 000 new aircraft, valued at about HK\$6,100 billion (US\$780 billion), accounting for more than 40% of the forecasted deliveries to the Asia Pacific region⁷. While aircraft leasing business used to be concentrated in Ireland, there has been trendsetting migration of lessors to Asia in recent years, driven mainly by growth in the aviation sector in the Mainland. Intra-Asia activities are particularly noticeable.

Providing a conducive environment to offshore aircraft leasing transactions in Hong Kong

5. Up to now, there is not a strong presence of aircraft leasing business in Hong Kong. Some potential companies comment that our profits tax rate – at 16.5% – is relatively high. In addition, according to the prevailing tax rules of Hong Kong, depreciation allowances are denied for offshore leasing activities. Compared with some major aircraft leasing hubs in the world, our

⁴ Source: *Current Market Outlook 2016-2035, World regions* published by Boeing Capital. All dollars values are in 2015 prices.

⁵ Source: *The Commercial Aircraft Leasing Market 2011-2021* by market consultant, Visiongain Ltd in 2011

⁶ Source: *Current Aircraft Finance Market Outlook 2017* published on Boeing's website

⁷ Source: *Current Market Outlook 2012-2032, China* published by Boeing Capital.

tax treaty network is also relatively limited⁸. These factors could be disincentives to aircraft lessors.

The competitive edge of Hong Kong

6. As a successful international financial centre, Hong Kong already possesses favourable conditions necessary for developing aircraft leasing business, namely, our sound legal and banking systems, well-developed and diversified capital markets, excellent aviation infrastructure and talents, and proximity to the Mainland market. Hong Kong should not miss the opportunity of taking a share in the global aircraft leasing business to strengthen Hong Kong's economic capabilities and position as a financial centre.

7. In April 2015, Hong Kong and the Mainland signed the Fourth Protocol to the 2008 Double Taxation Arrangement between Hong Kong and the Mainland, which reduces the withholding tax rate from 7% to 5% on lease rentals derived from aircraft and ship leasing businesses covered under the Royalties Article (lower than the 6% rate in the Mainland's double taxation agreements with our main competitors (Ireland and Singapore)). This provides a solid foundation for Hong Kong to attract global lessors, including those from the Mainland.

8. To make the best use of our strengths to develop aircraft leasing business, we propose to introduce profits tax concessions for qualifying aircraft lessors and qualifying aircraft leasing managers (see paragraph 9 below) to foster a more conducive environment for offshore aircraft leasing transactions in Hong Kong. We also propose a suitable anti-tax avoidance mechanism to guard against possible abuse (see paragraphs 10 to 14 below). Our vision is to enhance, through strengthening our competitiveness in attracting offshore aircraft leasing activities, the status of Hong Kong as an international financial centre and Hong Kong's soft power as an international aviation hub.

The proposed dedicated tax regime

9. In order to strengthen the competitiveness of Hong Kong for offshore aircraft leasing activities, and minimise the impact of any purpose-specific tax measures on other parts of the existing tax regime, we propose providing for a new standalone tax regime under the Inland Revenue Ordinance (IRO), which is comparable to the existing onshore aircraft leasing tax regime, for

⁸ To date, Hong Kong has concluded comprehensive avoidance of double taxation agreements with 37 jurisdictions (including some pending entry into force).

qualifying aircraft lessors and qualifying aircraft leasing managers in which –

- (a) the tax rate on the qualifying profits of qualifying aircraft lessors and qualifying aircraft leasing managers will be 50% of the prevailing profits tax rate for corporations (i.e. $16.5\% \times 50\% = 8.25\%$); and
- (b) as compensation for loss of depreciation allowances, the taxable amount of lease payments derived from leasing of an aircraft to a non-Hong Kong aircraft operator by a qualifying aircraft lessor will be equal to 20% of the tax base, i.e. gross lease payments less deductible expenses (excluding tax depreciation).

10. Profits derived from qualifying aircraft leasing and aircraft leasing management activities carried out by a corporation under specified conditions will be entitled to the above proposed profits tax concessions. The specified conditions for qualifying aircraft leasing activity are –

- (a) the activity is carried out in the ordinary course of the corporation's business carried on in Hong Kong; and
- (b) the aircraft is owned by the corporation, and is leased to a non-Hong Kong aircraft operator, when the activity is carried out.

11. For qualifying aircraft leasing management activity, in addition to the condition as specified in paragraph 10(a) above, it is subject to the following additional specified conditions –

- (a) the activity is carried out for another corporation during the basis period of the other corporation for a year of assessment;
- (b) the other corporation is a qualifying aircraft lessor for that year of assessment; and
- (c) the aircraft is owned by the other corporation, and is leased to a non-Hong Kong aircraft operator, when the activity is carried out.

12. To prevent cross-border tax abuse via sub-leasing, for example, an intermediate lessor is set up in Hong Kong to claim treaty benefit and concessionary tax treatment under this proposed regime while the head lessor can still enjoy tax depreciation in another jurisdiction, the subject aircraft must be acquired and owned by the qualifying aircraft lessor which

should be a standalone corporate entity engaging only in qualifying aircraft leasing activities.

13. While setting up a Special Purpose Vehicle with the only activity of holding an aircraft for leasing is the most common form of structure for aircraft lessors in aviation finance industry, it may not be the case for aircraft leasing managers. Therefore, a safe harbour rule is prescribed to allow aircraft leasing managers having profits primarily from, and assets primarily for, their aircraft leasing management activities to enjoy the half-rate. We also propose empowering the Commissioner of Inland Revenue (CIR) to determine that a corporation is a qualifying aircraft leasing manager and hence eligible for the half-rate regime if the CIR is of the opinion that the relevant conditions or safe harbour rule would, in the ordinary course of its business, have been satisfied.

14. To prevent possible abuses, anti-avoidance provisions are prescribed to ensure, among others, that the half-rate concession will apply to assessable profits in respect of which the corresponding payments are not tax deductible in Hong Kong, so as to prevent revenue loss where there is half taxation of qualifying profits by qualifying aircraft lessors and qualifying aircraft leasing managers but full deduction of the corresponding payments by associated corporations.

15. We also propose amending the IRO to make it clear that the “operation test”⁹ applies in determining the source of income derived from the business of qualifying aircraft lessors or qualifying aircraft leasing managers. The place where the aircraft is used is not the test in determining the source of the income. A qualifying aircraft lessor or qualifying aircraft leasing manager carrying on a business in Hong Kong is subject to Hong Kong profits tax in respect of its profits derived from such business.

Potential benefits of the proposal¹⁰

16. According to the analysis conducted by the Focus Group on Promoting Aerospace Financing in Hong Kong (the Focus Group) under the

⁹ It was held in *Orion Caribbean Limited v Commissioner of Inland Revenue* (4HKTC 432) that, where the taxpayer earned its profits by borrowing and lending of money, the source of profits should not be solely determined by the place where money was lent. The proper test to determine the source of the profits is the “operation test”, i.e. “one looks to see what the taxpayer has done to earn the profit in question and where he has done it”.

¹⁰ The potential benefits of the proposal are estimated based on the proposed dedicated regime with a tax rate of 8.25% (i.e. half of the prevailing profits tax rate) and the taxable amount of lease payments at 20% of the tax base.

Working Group on Transportation (TWG) of the Economic Development Commission (EDC)¹¹, if Hong Kong is able to develop a new tax regime for offshore aircraft leasing, Hong Kong could gradually capture up to about 18% of aircraft leasing business in the global aircraft leasing market in 20 years' time. This would bring about the following potential benefits by Year 20 –

- (a) financing for over 3 200 aircraft with an asset value of about HK\$707 billion;
- (b) direct employment of around 1 640 people and about HK\$2 billion in staff compensation;
- (c) profits tax paid by aircraft leasing companies of about HK\$1 billion in Year 20 and a total of more than HK\$10 billion over a 20-year period;
- (d) a cumulative Gross Domestic Product value added of over HK\$430 billion over a 20-year period; and
- (e) over 13 700 indirect jobs due to the linkage and multiplier effects.

The proposed tax regime is expected to make offshore aircraft leasing business much more attractive in Hong Kong. A comparison between onshore and offshore aircraft leasing transaction before and after the proposed tax regime is at **Annex B**.

B

17. According to the reality check focusing on the banking and financial sectors conducted by the Hong Kong Monetary Authority, Hong Kong should be in a good position to capture opportunities arising from the growing aircraft leasing sector if the proposed tax scheme is implemented.

THE BILL

18. The Bill provides for the profits tax concessions for qualifying aircraft lessors and qualifying aircraft leasing managers on certain businesses in connection with aircraft (paragraphs 9 to 14 above), makes provisions for profits tax purposes regarding businesses in connection with aircraft

¹¹ The EDC was established in 2013 to provide visionary direction and advice to the Government on the overall strategy and policy to broaden Hong Kong's economic base and to enhance Hong Kong's economic growth and development; and, in particular, to explore and identify growth sectors or clusters of sectors which present opportunities for Hong Kong's further economic growth, and recommend possible policy and other support for these industries. Working Group on Transportation is one of the four working groups under the EDC.

(paragraph 15 above), and makes consequential and minor textual amendments to the IRO. The main provisions of the Bill are as follows –

- (a) **Clauses 4 and 15** add new sections 14G to 14N and new Schedule 17F to the IRO to –
 - (i) define what are the qualifying aircraft leasing activities and qualifying aircraft leasing management activities for the proposed tax concessions (new section 14G and new schedule 17F);
 - (ii) provide for profits tax concessions to qualifying aircraft lessors and qualifying aircraft leasing managers (new sections 14H, 14I and 14J);
 - (iii) provide for the safe harbour rule for being a qualifying aircraft leasing manager (new section 14K);
 - (iv) provide for CIR's power to determine that a corporation is a qualifying aircraft leasing manager (new section 14L);
 - (v) provide for anti-avoidance provisions (new section 14M);
- (b) **Clause 5** amends section 15 of the IRO to deem sums received by or accrued to a corporation from carrying on certain businesses in connection with aircraft as having a Hong Kong source, even if the aircraft is used outside Hong Kong;
- (c) **Clause 6** amends consequentially section 19CA of the IRO to provide for adjustments in respect of relevant losses to be set off against the concessionary trading receipt chargeable to tax under new section 14H or 14J, or vice versa;
- (d) **Clauses 8 to 11** amend section 37, 38, 39B and 39D of the IRO respectively to deal with computation of the cost and capital expenditure in relation to an aircraft that is used by a corporation for a qualifying aircraft leasing activity before being used in another trade, profession or business; and
- (e) **Clauses 13 and 16** respectively amend section 89 of the IRO and add a new Schedule 41 to the IRO to provide for transitional matters.

LEGISLATIVE TIMETABLE

19. The legislative timetable will be –

Publication in the Gazette	10 March 2017
First Reading and commencement of Second Reading debate	22 March 2017
Resumption of Second Reading debate, committee stage and Third Reading	to be notified

IMPLICATIONS OF THE PROPOSAL

20. The Bill is in conformity with the Basic Law, including the provisions concerning human rights. It has no civil service, competition, environmental, family, gender or productivity implication. The amendments proposed in the Bill will not affect the current binding effect of the IRO.

Financial implications

21. As mentioned in paragraph 16 above, according to the analysis conducted by TWG of the EDC, if Hong Kong is able to develop a new tax regime for offshore aircraft leasing, Hong Kong could gradually capture up to about 18% of aircraft leasing business in the global aircraft leasing market in 20 years' time. This would mean (by Year 20) –

- (a) financing for over 3 200 aircraft with an asset value of about HK\$707 billion; and
- (b) profits tax paid by aircraft leasing companies of about HK\$1 billion in Year 20 and a total of more than HK\$10 billion over a 20-year period.

22. On financial implications, the revenue foregone arising from the profits tax concession should not be significant as currently the offshore aircraft leasing industry does not have any significant presence in Hong Kong. If the presence of the industry can be strengthened in Hong Kong by the proposed profits tax concession, this can potentially bring in additional direct and indirect tax revenue.

Economic implications

23. The proposed tax concessions may strengthen the presence of offshore aircraft leasing activities in Hong Kong, thereby generating further demand for the financial and professional services, including asset management, legal and accounting services. This would help broaden the depth and breadth of Hong Kong's economy and be conducive to enhancing the status of Hong Kong as an international financial centre and business hub.

Sustainability implications

24. The proposed profits tax concessions would strengthen the competitiveness of Hong Kong for offshore aircraft leasing activities, which might in turn generate more job opportunities for practitioners in professions relevant to aircraft leasing business.

PUBLIC CONSULTATION

25. The proposed dedicated tax regime for aircraft leasing business was developed in consultation with the EDC and the TWG under it. We have incorporated technical input from the Focus Group under the TWG, in which aviation industry stakeholders, legal professionals and consultants specialising in large asset financing are represented. In the meantime, we have also established initial contact with some aircraft leasing companies. These companies indicated that they are interested in making use of Hong Kong as a platform to enter into the Mainland and Asian markets.

26. Local airlines will not directly benefit from the proposed dedicated tax regime. However, local airlines believe that promoting aircraft leasing business in Hong Kong will enhance the soft power of Hong Kong in being an international aviation hub. They are supportive of the proposal.

27. Promoting aircraft leasing business in Hong Kong was among the initiatives of the Chief Executive's Policy Address in 2015, 2016 and 2017. The Financial Secretary also mentioned in the 2017-18 Budget that the Government plans to introduce a bill into the LegCo in 2017 to amend the IRO to offer tax concession.

28. We briefed the Economic Development Panel of the LegCo on the proposed dedicated tax regime on 23 January 2017. The Panel was very supportive of this proposal. Members agreed that developing aircraft leasing

business in Hong Kong would bring new impetus to our economy. They urged the Administration to expedite work with a view to tabling the proposed amendment bill at the LegCo as soon as possible.

PUBLICITY

29. We will issue press release upon gazettal of the Bill, and arrange a spokesperson to answer media enquiries.

ENQUIRIES

30. Enquiries relating to the brief can be directed to Ms Candy Nip, Principal Assistant Secretary for Transport and Housing (Transport) at 3509 8194.

Transport and Housing Bureau
Financial Services and the Treasury Bureau
8 March 2017

Inland Revenue (Amendment) (No. 2) Bill 2017**Contents**

Clause		Page
1.	Short title	1
2.	Inland Revenue Ordinance amended	1
3.	Section 2 amended (interpretation).....	1
4.	Sections 14G to 14N added	2
14G.	Aircraft leasing tax concessions: interpretation.....	2
14H.	Aircraft leasing tax concessions: concession for qualifying aircraft lessor	11
14I.	Aircraft leasing tax concessions: calculation of net lease payments	13
14J.	Aircraft leasing tax concessions: concession for qualifying aircraft leasing manager	15
14K.	Aircraft leasing tax concessions: safe harbour rule	17
14L.	Aircraft leasing tax concessions: Commissioner's determination	20
14M.	Aircraft leasing tax concessions: anti-avoidance provisions	21
14N.	Aircraft leasing tax concessions: power to amend Schedule 17F	24

Clause		Page
5.	Section 15 amended (certain amounts deemed trading receipts)	24
6.	Section 19CA amended (treatment of losses: concessionary trading receipts)	25
7.	Section 20AA amended (persons not treated as agents)	26
8.	Section 37 amended (initial and annual allowances, machinery or plant)	27
9.	Section 38 amended (balancing allowances and charges, machinery or plant)	28
10.	Section 39B amended (initial and annual allowances on machinery or plant under the pooling system)	28
11.	Section 39D amended (balancing allowances and charges under the pooling system)	29
12.	Section 80D amended (offences of service provider)	29
13.	Section 89 amended (transitional provisions)	29
14.	Schedule 8 amended (rate of profits tax in respect of a corporation)	30
15.	Schedule 17F added	30
	Schedule 17F Aircraft Leasing Tax Concessions	30
16.	Schedule 41 added	33
	Schedule 41 Transitional Provisions for Inland Revenue (Amendment) (No. 2) Ordinance 2017	33

A BILL

To

Amend the Inland Revenue Ordinance to give profits tax concessions to qualifying aircraft lessors and qualifying aircraft leasing managers; to make provisions for profits tax purposes about businesses in connection with aircraft; and to make consequential and minor textual amendments.

Enacted by the Legislative Council.

1. Short title

This Ordinance may be cited as the Inland Revenue (Amendment) (No. 2) Ordinance 2017.

2. Inland Revenue Ordinance amended

The Inland Revenue Ordinance (Cap. 112) is amended as set out in sections 3 to 16.

3. Section 2 amended (interpretation)

- (1) Section 2(1), definition of *lease*, before “in relation to any machinery”—

Add

“except in the aircraft leasing tax concessions provisions and Schedule 17F,”.

- (2) Section 2(1)—

Add in alphabetical order

“*aircraft leasing tax concessions provisions* (飛機租賃稅務寬減條文) means sections 14G, 14H, 14I, 14J, 14K, 14L, 14M and 14N;”.

4. Sections 14G to 14N added

After section 14F—

Add

“14G. Aircraft leasing tax concessions: interpretation

- (1) In the aircraft leasing tax concessions provisions—

actual residual value (實際剩餘價值), in relation to an aircraft, means the actual fair market value of the aircraft at the end of the term of a lease or its useful economic life;

aircraft (飛機)—

- (a) includes an aeroplane, airframe, aircraft engine and helicopter; but
- (b) does not include an aircraft solely for military use, airship, spacecraft or satellite;

aircraft engine (飛機引擎) means an engine—

- (a) that is used or to be used in an aircraft; and
- (b) that—
 - (i) is powered by jet propulsion and has at least 1 750 lb of thrust or its equivalent; or
 - (ii) is powered by turbine or piston technology and has at least 550 rated take-off shaft horsepower or its equivalent,

together with any aircraft engine component;

aircraft engine component (飛機引擎組件), in relation to an engine, means—

- (a) a module or other installed, incorporated or attached accessory, part or equipment of the engine; or
 - (b) data, manual or record relating to the engine;
- aircraft leasing activity** (飛機租賃活動)—see section 1(1) of Schedule 17F;
- aircraft leasing management activity** (飛機租賃管理活動)—see section 1(1) of Schedule 17F;
- aircraft leasing management asset** (飛機租賃管理資產), in relation to a corporation, means an asset of the corporation used by it to carry out a qualifying aircraft leasing management activity;
- aircraft leasing management profits** (飛機租賃管理利潤), in relation to a corporation, means any profits of the corporation that are derived from a qualifying aircraft leasing management activity;
- aircraft operation business** (飛機營運業務)—
- (a) means a business of operating aircraft as an owner or a charterer for providing services for the carriage by air of passengers, cargo or mail; but
 - (b) does not include dealing in aircraft or agency business in connection with air transport;
- aircraft operator** (飛機營運商) means a person carrying on an aircraft operation business;
- associate** (相聯者), in relation to a corporation, means—
- (a) a person who has control over the corporation;
 - (b) a partner of the person mentioned in paragraph (a);
 - (c) if a person mentioned in paragraph (a) is a natural person, a relative of the person;

- (d) if a partner mentioned in paragraph (b) is a natural person, a relative of the partner;
 - (e) a director or principal officer of—
 - (i) the corporation; or
 - (ii) an associated corporation of the corporation;
 - (f) a relative of a director (if the director is a natural person) or principal officer mentioned in paragraph (e);
 - (g) a partner of the corporation;
 - (h) if a partner of the corporation is a natural person, a relative of the partner;
 - (i) a partnership in which the corporation is a partner; or
 - (j) an associated corporation of the corporation;
- associated corporation** (相聯法團), in relation to a corporation, means—
- (a) another corporation over which the corporation has control;
 - (b) another corporation that has control over the corporation; or
 - (c) another corporation that is under the control of the same person as is the corporation;
- connected person** (有關連者), in relation to a corporation, means—
- (a) an associated corporation of the corporation;
 - (b) a person (other than a corporation)—
 - (i) over whom the corporation has control;
 - (ii) who has control over the corporation; or

(iii) who is under the control of the same person as is the corporation; or

(c) a partnership in which the corporation or its associate is a partner;

control (控制), in relation to the definitions of *associate*, *associated corporation* and *connected person*—see subsection (2);

dry lease (淨租機租約) means an arrangement under which—

(a) an aircraft is bona fide demised, let or hired out, or a right to use an aircraft is otherwise granted, by a person (*lessor*) to another person for a term exceeding 1 year;

(b) the lessor is not responsible for ensuring the airworthiness of the aircraft; and

(c) no member of the crew of the aircraft is employed by the lessor;

estimated residual value (估計剩餘價值), in relation to an aircraft, means an estimated fair market value of the aircraft at the end of the term of a lease or its useful economic life;

funding lease (融購租約) means a dry lease of an aircraft—

(a) that satisfies one of the following conditions at its inception—

(i) the dry lease is accounted for as a finance lease or loan by the lessor in accordance with—

(A) the Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public

Accountants, as in force from time to time; or

(B) the International Financial Reporting Standards issued by the International Accounting Standards Board, as in force from time to time;

(ii) the present value of the aggregate minimum lease payments (whether or not they are periodic payments and including any sum payable under a residual value guarantee) during the term of the dry lease is equal to or more than 80% of the fair market value of the aircraft;

(iii) the term of the dry lease is equal to or more than 65% of the remaining useful economic life of the aircraft; and

(b) under which the property in the aircraft will or may pass to the lessee at the end of its term,

and includes an arrangement or agreement in connection with such a dry lease;

Note—

See also subsections (3) and (4).

lease (租約), when used as a noun—

(a) means a dry lease; but

(b) does not include a dry lease that is a funding lease, hire-purchase agreement or conditional sale agreement,

and **lease** (租賃), when used as a verb, is to be construed accordingly;

Note—

See also subsection (5).

non-Hong Kong aircraft operator (非香港飛機營運商) means an aircraft operator who is not chargeable to profits tax under this Ordinance;

own (擁有) includes—

- (a) to hold as a lessee under a funding lease;
- (b) to hold as a bailee under a hire-purchase agreement; and
- (c) to hold as a buyer under a conditional sale agreement;

Note—

See also subsection (5).

permanent establishment (常設機構)—

- (a) means a branch, management or other place of business; but
- (b) does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of the principal;

prescribed asset percentage (訂明資產百分率)—see section 4 of Schedule 17F;

prescribed profits percentage (訂明利潤百分率)—see section 3 of Schedule 17F;

principal officer (主要職員), in relation to a corporation, means—

- (a) a person employed by the corporation who, either alone or jointly with one or more other persons, is responsible under the immediate authority of the

directors of the corporation for the conduct of the business of the corporation; or

- (b) a person employed by the corporation who, under the immediate authority of a director of the corporation or a person to whom paragraph (a) applies, exercises managerial functions in respect of the corporation;

qualifying aircraft leasing activity (合資格飛機租賃活動)—see subsection (6);

qualifying aircraft leasing management activity (合資格飛機租賃管理活動)—see subsection (7);

qualifying aircraft leasing manager (合資格飛機租賃管理商)—see section 14J(2);

qualifying aircraft lessor (合資格飛機出租商)—see section 14H(2);

relative (親屬), in relation to a person, means the spouse, parent, child, brother or sister of the person, and, in deducing such a relationship—

- (a) an adopted child is to be regarded as a child of both the natural parents and any adopting parent; and
- (b) a step child is to be regarded as a child of both the natural parents and any step parent;

residual value guarantee (剩餘價值擔保), in relation to an aircraft, means a financial commitment to pay a sum by reference to the amount by which the estimated residual value of the aircraft exceeds the actual residual value of the aircraft.

- (2) For the purposes of the definitions of *associate*, *associated corporation* and *connected person* in subsection (1)—

- (a) a person has control over a corporation if the person has the power to secure—
 - (i) by means of the holding of shares or the possession of voting power in or in relation to that or any other corporation; or
 - (ii) by virtue of any powers conferred by the articles of association or other document regulating that or any other corporation,
 that the affairs of the first-mentioned corporation are conducted in accordance with the wishes of that person; and
 - (b) a person (*first-mentioned person*) has control over another person (other than a corporation) (*second-mentioned person*) if the second-mentioned person is accustomed or under an obligation (whether express or implied, and whether or not enforceable or intended to be enforceable by legal proceedings) to act, in relation to the investment or business affairs of the second-mentioned person, in accordance with the directions, instructions or wishes of the first-mentioned person.
- (3) For the purposes of the definition of *funding lease* in subsection (1), subsection (4) applies if, under 2 or more dry leases, an aircraft is demised, let or hired out, or a right to use an aircraft is otherwise granted—
- (a) to a corporation; or
 - (b) to a corporation and to its associate or associates, unless, in the opinion of the Commissioner, the dry leases do not form part of a single arrangement.
- (4) Regardless of whether the term of one of the dry leases mentioned in subsection (3) is immediately followed by

that of another, the dry leases are to be treated as one single dry lease—

- (a) for computing the present value of the aggregate minimum lease payments under paragraph (a)(ii) of that definition; and
 - (b) for computing the term of the dry lease under paragraph (a)(iii) of that definition.
- (5) In the definitions of *lease* and *own* in subsection (1), a reference to a funding lease, hire-purchase agreement or conditional sale agreement does not include one under which, in the opinion of the Commissioner, the property in the aircraft concerned would reasonably be expected not to pass to the lessee, bailee or buyer (as the case may be).
- (6) An aircraft leasing activity carried out by a corporation in respect of an aircraft is a qualifying aircraft leasing activity if—
- (a) the activity is carried out in the ordinary course of the corporation's business carried on in Hong Kong; and
 - (b) the aircraft is owned by the corporation, and is leased to a non-Hong Kong aircraft operator, when the activity is carried out.
- (7) An aircraft leasing management activity carried out by a corporation in respect of an aircraft is a qualifying aircraft leasing management activity if—
- (a) the activity is carried out in the ordinary course of the corporation's business carried on in Hong Kong;

- (b) the activity is carried out for another corporation in the basis period of the other corporation for a year of assessment;
 - (c) the other corporation is a qualifying aircraft lessor for that year of assessment; and
 - (d) the aircraft is owned by the other corporation, and is leased to a non-Hong Kong aircraft operator, when the activity is carried out.
- (8) A note located in the text of this section is provided for information only and has no legislative effect.

14H. Aircraft leasing tax concessions: concession for qualifying aircraft lessor

- (1) For the purposes of this Part and subject to subsections (4), (6) and (7), the assessable profits of a corporation that is a qualifying aircraft lessor for a year of assessment are chargeable to tax under this Part at one-half of the rate specified in Schedule 8 to the extent to which those profits are assessable profits derived from its qualifying aircraft leasing activity.
- (2) A corporation is a qualifying aircraft lessor for a year of assessment if, in the basis period for that year of assessment—
 - (a) it is not an aircraft operator;
 - (b) it has carried out in Hong Kong one or more qualifying aircraft leasing activities; and
 - (c) it has not carried out in Hong Kong any activity other than a qualifying aircraft leasing activity.
- (3) For the purposes of subsection (2)(c), in determining whether a corporation has carried out any activity other than a qualifying aircraft leasing activity, only activities

- that generate income to the corporation are to be taken into account.
- (4) Subsection (1) applies to a corporation for a year of assessment only if—
 - (a) in that year of assessment—
 - (i) the central management and control of the corporation is exercised in Hong Kong;
 - (ii) the activities that produce its qualifying profits in that year are—
 - (A) carried out in Hong Kong by the corporation; or
 - (B) arranged by the corporation to be carried out in Hong Kong; and
 - (iii) those activities are not carried out by a permanent establishment outside Hong Kong; and
 - (b) the corporation has elected in writing that subsection (1) applies to it.
- (5) An election under subsection (4)(b), once made, is irrevocable.
- (6) If subsection (1) does not apply to a corporation for a year of assessment (*cessation year*) while it did for the previous year of assessment—
 - (a) the election made by the corporation under subsection (4)(b) ceases to be effective; and
 - (b) despite anything in this section, subsection (1) is not to apply to the corporation for the year of assessment that follows the cessation year.
- (7) In computing the qualifying profits of a corporation for the purposes of subsection (1), if a sum payable to the

corporation by a person for the qualifying aircraft leasing activity is deductible under this Part, the amount of the qualifying profits attributable to that activity is to be deducted by reference to the amount of that sum.

- (8) An aircraft owned by a corporation is to be treated as a capital asset of the corporation for the purposes of this Part if—
- (a) the corporation uses the aircraft for carrying out a qualifying aircraft leasing activity for a continuous period of not less than 3 years immediately before it disposes of the aircraft; and
 - (b) subsection (1) applies in relation to that activity for any year of assessment.

- (9) In this section—

qualifying profits (合資格利潤), in relation to a corporation, means the assessable profits of the corporation that fall within subsection (1).

14I. Aircraft leasing tax concessions: calculation of net lease payments

- (1) If section 14H(1) applies to a corporation that is a qualifying aircraft lessor for a year of assessment, then subsection (2) applies for computing the assessable profits of the corporation derived from its qualifying aircraft leasing activity in relation to a lease for that year of assessment.
- (2) The net lease payments for the right to use an aircraft under the lease are to be calculated in accordance with the following formula—

$$A = (B - C) \times D$$

where: A means the net lease payments;

B means the aggregate amount of the gross lease payments (whether or not they are periodic payments and including any sum payable under a residual value guarantee) earned by or accrued to the corporation under the lease during the basis period for the year of assessment;

C means the aggregate amount of any outgoings and expenses deductible under this Part to the extent to which they are incurred during the basis period for the year of assessment by the corporation in the production of those gross lease payments (*relevant outgoings and expenses*); and

D means the percentage prescribed in section 2 of Schedule 17F.

- (3) Despite subsection (1), subsection (2) does not apply to a corporation for a year of assessment if—
- (a) the corporation has not incurred capital expenditure on the provision of the aircraft concerned;
 - (b) allowances under Part 6 have been granted to a connected person of the corporation in respect of the capital expenditure on the provision of the aircraft concerned incurred before the aircraft is owned by the corporation; or
 - (c) capital allowances are granted to a connected person of the corporation, whether in Hong Kong or in a territory outside Hong Kong, for that year of assessment in respect of the capital expenditure on the provision of the aircraft concerned.

- (4) If an aircraft is leased to a non-Hong Kong aircraft operator together with other dealings in pursuance of one bargain, then for calculating the net lease payments under subsection (2), the Commissioner must, having regard to all the circumstances of the bargain, allocate an amount of gross lease payments for the right to use the aircraft under the lease.
- (5) If subsection (2) applies, the relevant outgoings and expenses may not be claimed for deduction under this Part otherwise than for calculating the net lease payments under that subsection.

14J. Aircraft leasing tax concessions: concession for qualifying aircraft leasing manager

- (1) For the purposes of this Part and subject to subsections (5), (7) and (8), the assessable profits of a corporation that is a qualifying aircraft leasing manager for a year of assessment are chargeable to tax under this Part at one-half of the rate specified in Schedule 8 to the extent to which those profits are assessable profits derived from its qualifying aircraft leasing management activity.
- (2) A corporation is a qualifying aircraft leasing manager for a year of assessment if—
 - (a) in the basis period for that year of assessment, it is not an aircraft operator; and
 - (b) for that year of assessment—
 - (i) it satisfies the conditions specified in subsection (3);
 - (ii) it satisfies the safe harbour rule under section 14K; or

- (iii) it has obtained the Commissioner's determination under section 14L(1).
- (3) For the purposes of subsection (2)(b)(i), the conditions are that, in the basis period for the year of assessment, the corporation—
 - (a) has carried out in Hong Kong one or more qualifying aircraft leasing management activities; and
 - (b) has not carried out in Hong Kong any activity other than a qualifying aircraft leasing management activity.
- (4) For the purposes of subsection (3)(b), in determining whether a corporation has carried out any activity other than a qualifying aircraft leasing management activity, only activities that generate income to the corporation are to be taken into account.
- (5) Subsection (1) applies to a corporation for a year of assessment only if—
 - (a) in that year of assessment—
 - (i) the central management and control of the corporation is exercised in Hong Kong;
 - (ii) the activities that produce its qualifying profits in that year are—
 - (A) carried out in Hong Kong by the corporation; or
 - (B) arranged by the corporation to be carried out in Hong Kong; and
 - (iii) those activities are not carried out by a permanent establishment outside Hong Kong; and

- (b) the corporation has elected in writing that subsection (1) applies to it.
- (6) An election under subsection (5)(b), once made, is irrevocable.
- (7) If subsection (1) does not apply to a corporation for a year of assessment (*cessation year*) while it did for the previous year of assessment—
 - (a) the election made by the corporation under subsection (5)(b) ceases to be effective; and
 - (b) despite anything in this section, subsection (1) is not to apply to the corporation for the year of assessment that follows the cessation year.
- (8) In computing the qualifying profits of a corporation for the purposes of subsection (1), if a sum payable to the corporation by a person for the qualifying aircraft leasing management activity is deductible under this Part, the amount of the qualifying profits attributable to that activity is to be deducted by reference to the amount of that sum.
- (9) Subsection (8) does not apply in relation to a sum payable to the corporation for a qualifying aircraft leasing management activity carried out by it.
- (10) In this section—

qualifying profits (合資格利潤), in relation to a corporation, means the assessable profits of the corporation that fall within subsection (1).

14K. Aircraft leasing tax concessions: safe harbour rule

- (1) For the purposes of section 14J(2)(b)(ii), a corporation satisfies the safe harbour rule for a year of assessment (*subject year*) if the corporation falls within—

- (a) the 1-year safe harbour under subsection (2); or
- (b) the multiple-year safe harbour under subsection (3).
- (2) A corporation falls within the 1-year safe harbour if, for the subject year—
 - (a) its ALMP percentage is not lower than the prescribed profits percentage; and
 - (b) its ALMA percentage is not lower than the prescribed asset percentage.
- (3) A corporation falls within the multiple-year safe harbour if, for the specified years—
 - (a) its average ALMP percentage is not lower than the prescribed profits percentage; and
 - (b) its average ALMA percentage is not lower than the prescribed asset percentage.
- (4) In this section, a reference to the specified years for a corporation is a reference to—
 - (a) if the corporation has carried on a trade, profession or business in Hong Kong for less than 2 consecutive years of assessment immediately before the subject year—the subject year and the preceding year of assessment (*the 2 years*); or
 - (b) if the corporation has carried on a trade, profession or business in Hong Kong for 2 or more consecutive years of assessment immediately before the subject year—the subject year and the preceding 2 years of assessment (*the 3 years*).
- (5) The ALMP percentage of a corporation for a year of assessment is calculated in accordance with the following formula—

$$\frac{\text{ALMP}}{P}$$

where: ALMP means the aggregate amount of the aircraft leasing management profits of the corporation in the basis period for the year of assessment; and

P means the aggregate amount of profits accruing to the corporation from all sources, whether in Hong Kong or not, in the basis period for the year of assessment.

- (6) The ALMA percentage of a corporation for a year of assessment is calculated in accordance with the following formula—

$$\frac{\text{ALMA}}{A}$$

where: ALMA means the aggregate value of the aircraft leasing management assets of the corporation as at the end of the basis period for the year of assessment; and

A means the aggregate value of all assets, whether in Hong Kong or not, of the corporation as at the end of the basis period for the year of assessment.

- (7) For the purposes of subsection (6), in computing the aggregate value of the aircraft leasing management assets of a corporation, if an aircraft leasing management asset is used partly to carry out a qualifying aircraft

leasing management activity and partly for another purpose, only the part of the value of the asset that is proportionate to the extent to which the asset is used to carry out a qualifying aircraft leasing management activity is to be taken into account.

- (8) A reference to the average ALMP percentage of a corporation for the specified years is a reference to the percentage arrived at by—

(a) if subsection (4)(a) applies—dividing the sum of the ALMP percentages of the corporation for the 2 years by 2; or

(b) if subsection (4)(b) applies—dividing the sum of the ALMP percentages of the corporation for the 3 years by 3.

- (9) A reference to the average ALMA percentage of a corporation for the specified years is a reference to the percentage arrived at by—

(a) if subsection (4)(a) applies—dividing the sum of the ALMA percentages of the corporation for the 2 years by 2; or

(b) if subsection (4)(b) applies—dividing the sum of the ALMA percentages of the corporation for the 3 years by 3.

14L. Aircraft leasing tax concessions: Commissioner's determination

- (1) For the purposes of section 14J(2)(b)(iii), the Commissioner may, on application by a corporation, determine that the corporation is a qualifying aircraft leasing manager for a year of assessment.

- (2) A corporation may apply for the Commissioner's determination under subsection (1) only if—
- (a) it is not an aircraft operator; and
 - (b) for the year of assessment, it satisfies neither of the following—
 - (i) the conditions specified in section 14J(3);
 - (ii) the safe harbour rule under section 14K.
- (3) The Commissioner may make a determination under subsection (1) only if the Commissioner is of the opinion that the conditions specified in section 14J(3), or the safe harbour rule under section 14K, would, in the ordinary course of business of the corporation, have been satisfied for the year of assessment.

14M. Aircraft leasing tax concessions: anti-avoidance provisions

- (1) Subsection (2) applies if—
- (a) conditions are made or imposed between a corporation that is a qualifying aircraft lessor and a person who is an associate of that corporation, in their commercial or financial relations in connection with a qualifying aircraft leasing activity; and
 - (b) the conditions differ from those that would be made if the person were not such an associate.
- (2) Any profits that, but for the conditions referred to in subsection (1)(a), would have accrued to the corporation or the person and, by reason of those conditions, have not so accrued, are to be included in the profits of the corporation or the person and taxed in accordance with this Part.
- (3) Subsection (4) applies if—

- (a) conditions are made or imposed between a corporation that is a qualifying aircraft leasing manager and a person who is an associate of that corporation, in their commercial or financial relations in connection with a qualifying aircraft leasing management activity; and
 - (b) the conditions differ from those that would be made if the person were not such an associate.
- (4) Any profits that, but for the conditions referred to in subsection (3)(a), would have accrued to the corporation or the person and, by reason of those conditions, have not so accrued, are to be included in the profits of the corporation or the person and taxed in accordance with this Part.
- (5) Subsection (6) applies if—
- (a) a corporation that is a qualifying aircraft lessor enters into an arrangement—
 - (i) under which the corporation leases an aircraft to a non-Hong Kong aircraft operator who in turn grants a right to use the aircraft to an aircraft operator chargeable to profits tax under this Ordinance (*end-user*); or
 - (ii) under which—
 - (A) the corporation leases an aircraft to a non-Hong Kong aircraft operator;
 - (B) the non-Hong Kong aircraft operator in turn grants a right to use the aircraft to an intermediary; and
 - (C) an intermediary (whether or not the same intermediary mentioned in sub-subparagraph (B)) grants a right to use

the aircraft to an aircraft operator chargeable to profits tax under this Ordinance (*end-user*); and

- (b) the Commissioner is satisfied that the main purpose, or one of the main purposes, of the arrangement is to avoid, postpone or reduce any liability of any person (*taxpayer*) to profits tax under this Ordinance.
- (6) The aircraft leasing tax concessions provisions are to have effect in relation to the assessment of the profits tax on the taxpayer as if the corporation—
 - (a) had not leased the aircraft to the non-Hong Kong aircraft operator; and
 - (b) had directly granted a right to use the aircraft to the end-user.
- (7) If—
 - (a) an aircraft is owned by a corporation that is a qualifying aircraft lessor under an arrangement (*ownership arrangement*); and
 - (b) the corporation enters into an arrangement (*release arrangement*) under which—
 - (i) it is released from the primary obligation under the ownership arrangement; and
 - (ii) that obligation is assumed by another person,

the aircraft leasing tax concessions provisions are to have effect as if the corporation had ceased to own the aircraft during the time when the release arrangement is in force.
- (8) In this section—

intermediary (中介人), in relation to an aircraft, means a person—

- (a) to whom a right to use the aircraft is granted; and
- (b) who in turn grants a right to use the aircraft to another person.

14N. Aircraft leasing tax concessions: power to amend Schedule 17F

The Commissioner may by order published in the Gazette amend Schedule 17F.”.

5. Section 15 amended (certain amounts deemed trading receipts)

- (1) Section 15(1)(la)(ii)—

Repeal

“and”.

- (2) Section 15(1)(m)—

Repeal

“15A.”

Substitute

“15A; and”.

- (3) After section 15(1)(m)—

Add

“(n) sums, not otherwise chargeable to tax under this Part, received by or accrued to a corporation by way of gains or profits (other than those arising from the sale of capital assets) arising through or from the carrying on in Hong Kong by the corporation of—

- (i) its business of granting a right to use an aircraft to another person (*aircraft business*), even if the aircraft is used outside Hong Kong; or
- (ii) its business of managing a corporation carrying on an aircraft business or of managing an aircraft business, even if the aircraft concerned is used outside Hong Kong.”

6. **Section 19CA amended (treatment of losses: concessionary trading receipts)**

(1) Section 19CA(4)—

Repeal

“section 14A, 14B or 14D, as the case may be,”

Substitute

“the relevant concession provision”.

(2) Section 19CA(5), definition of *chargeable concessionary trading receipts*, paragraph (a)—

Repeal

“section 14A”

Substitute

“a concession provision (other than section 14B)”.

(3) Section 19CA(5), definition of *chargeable concessionary trading receipts*—

Repeal paragraph (c).

(4) Section 19CA(5), definition of *concessionary trading receipts*—

Repeal

“section 14A, 14B or 14D”

Substitute

“a concession provision”.

(5) Section 19CA(5), definition of *unabsorbed loss in respect of the concessionary trading receipts*, paragraph (a)—

Repeal

“section 14A”

Substitute

“a concession provision (other than section 14B)”.

(6) Section 19CA(5), Chinese text, definition of 關於獲特惠的營業收入的未吸納虧損, paragraph (b)—

Repeal the semicolon

Substitute a full stop.

(7) Section 19CA(5), definition of *unabsorbed loss in respect of the concessionary trading receipts*—

Repeal paragraph (c).

(8) Section 19CA(5)—

Add in alphabetical order

“*concession provision* (寬減條文) means one of the following provisions—

- (a) section 14A;
- (b) section 14B;
- (c) section 14D;
- (d) section 14H;
- (e) section 14J;”.

7. **Section 20AA amended (persons not treated as agents)**

Section 20AA(6), English text, definition of *control*—

Repeal paragraph (b)

Substitute

“(b) by virtue of any powers conferred by the articles of association or other document regulating that or any other corporation,

that the affairs of the first-mentioned corporation are conducted in accordance with the wishes of that person;”.

8. Section 37 amended (initial and annual allowances, machinery or plant)

After section 37(2A)—

Add

“(2B) Subsection (2C) applies if an aircraft was owned and used by a corporation for carrying out a qualifying aircraft leasing activity before the corporation uses it in another trade, profession or business to produce profits chargeable to tax under Part 4.

(2C) For the purposes of subsection (2), the cost of the asset, in relation to the aircraft, is the sum computed by deducting from the actual cost the notional amount of annual allowances that would have been made under that subsection to the corporation if such annual allowances had been available to the corporation since it acquired the aircraft.

(2D) In subsections (2B) and (2C)—

aircraft (飛機) has the meaning given by section 14G(1);

qualifying aircraft leasing activity (合資格飛機租賃活動) has the meaning given by section 14G(6).”.

9. Section 38 amended (balancing allowances and charges, machinery or plant)

(1) Section 38(2), after “section 37(2A)” —

Add

“or (2C)”.

(2) Section 38(2) —

Repeal

“that subsection” (wherever appearing)

Substitute

“that section”.

10. Section 39B amended (initial and annual allowances on machinery or plant under the pooling system)

(1) Section 39B(4), after “(6)” —

Add

“, (6B)”.

(2) After section 39B(6) —

Add

“(6A) Subsection (6B) applies if an aircraft was owned and used by a corporation for carrying out a qualifying aircraft leasing activity before the corporation uses it in another trade, profession or business to produce profits chargeable to tax under Part 4.

(6B) For the purposes of subsection (4), the capital expenditure incurred on the provision of the aircraft is to be computed by deducting from the actual cost the notional amount of annual allowances that would have been made under section 37(2) to the corporation if such

annual allowances had been available to the corporation since it acquired the aircraft.

(6C) In subsections (6A) and (6B)—

aircraft (飛機) has the meaning given by section 14G(1);

qualifying aircraft leasing activity (合資格飛機租賃活動) has the meaning given by section 14G(6)."

11. Section 39D amended (balancing allowances and charges under the pooling system)

(1) Section 39D(7)(a), after "section 37(2A)"—

Add

"or (2C)".

(2) Section 39D(7)(b), after "section 39B(6)"—

Add

"or (6B)".

12. Section 80D amended (offences of service provider)

Section 80D(4)(a), Chinese text—

Repeal

"而在報表中提供"

Substitute

"而在報表中提供)".

13. Section 89 amended (transitional provisions)

Section 89—

Add

"(19) Schedule 41 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance

made by the Inland Revenue (Amendment) (No. 2) Ordinance 2017 (of 2017).".

14. Schedule 8 amended (rate of profits tax in respect of a corporation)

Schedule 8, after "14D(1),"—

Add

"14H(1), 14J(1),".

15. Schedule 17F added

After Schedule 17E—

Add

"Schedule 17F

[ss. 2, 14G, 14I &
14N]

Aircraft Leasing Tax Concessions

Part 1

Aircraft Leasing Activity and Aircraft Leasing Management Activity

1. Meaning of *aircraft leasing activity* and *aircraft leasing management activity*

(1) In this section and the aircraft leasing tax concessions provisions—

aircraft leasing activity (飛機租賃活動), in relation to a corporation, means leasing an aircraft by the corporation to an aircraft operator;

aircraft leasing management activity (飛機租賃管理活動), in relation to a corporation, means any of the following activities—

- (a) managing another corporation that is a relevant qualifying aircraft lessor;
- (b) establishment or administration of a special purpose entity for the purpose of owning an aircraft by that entity;
- (c) providing finance in obtaining the ownership of an aircraft by a special purpose entity wholly or partly owned by the corporation or its associated corporation;
- (d) providing a guarantee in respect of a financial or performance obligation as regards the aircraft leasing business of a special purpose entity wholly or partly owned by the corporation or its associated corporation, or granting security in respect of that business;
- (e) managing leases;
- (f) arranging for the procurement or leasing of aircraft;
- (g) arranging for the operation, maintenance, repair, insurance, storage, scrapping or modification of aircraft;
- (h) arranging for the evaluation, appraisal, provision or inspection of aircraft, airline facilities or maintenance facilities for aircraft;
- (i) arranging for the assessment of the aviation and aircraft market conditions;

- (j) marketing of leases that are operating leases;
 - (k) providing finance in obtaining the ownership of an aircraft by an airline enterprise from another corporation that is a relevant qualifying aircraft lessor;
 - (l) providing a residual value guarantee or contingent purchase arrangement;
 - (m) providing services in relation to an aircraft leasing activity for or to another corporation that is a relevant qualifying aircraft lessor.
- (2) For the purposes of paragraph (a), (k) or (m) of the definition of **aircraft leasing management activity** in subsection (1), a corporation is a relevant qualifying aircraft lessor if—
- (a) the activity mentioned in that paragraph is carried out in the basis period of the corporation for a year of assessment; and
 - (b) the corporation is a qualifying aircraft lessor for that year of assessment.
- (3) In paragraph (l) of the definition of **aircraft leasing management activity** in subsection (1)—
- contingent purchase arrangement** (待確定購買安排) means an arrangement under which a person is required to purchase an aircraft at a pre-determined amount if the actual residual value falls below the estimated residual value.
- (4) The words and expressions used in this section and defined in section 14G for the purposes of the aircraft leasing tax concessions provisions have the same meaning as in those provisions.

Part 2

Prescribed Percentage for Calculation of Net Lease Payments

2. Prescribed percentage for calculation of net lease payments

For the purposes of section 14I, the prescribed percentage is 20%.

Part 3

Prescribed Percentages for Safe Harbour Rule

3. Prescribed profits percentage

For the purposes of section 14K, the prescribed profits percentage is 75%.

4. Prescribed asset percentage

For the purposes of section 14K, the prescribed asset percentage is 75%.”.

16. Schedule 41 added

The Ordinance—

Add

“Schedule 41

[s. 89(19)]

Transitional Provisions for Inland Revenue (Amendment) (No. 2) Ordinance 2017

1. In computing the qualifying profits in relation to a corporation for the purposes of section 14H(1), sums received by or accrued to the corporation before 1 April 2017 are not to be taken into account.
2. In computing the qualifying profits in relation to a corporation for the purposes of section 14J(1), sums received by or accrued to the corporation before 1 April 2017 are not to be taken into account.
3. Section 15(1)(n) does not apply to sums received or accrued before the Inland Revenue (Amendment) (No. 2) Ordinance 2017 (of 2017) comes into operation.”.

Explanatory Memorandum

The main object of this Bill is to amend the Inland Revenue Ordinance (Cap. 112) (*principal Ordinance*) to give profits tax concessions to corporations carrying on certain businesses in connection with aircraft and to make provisions for profits tax purposes about such businesses.

2. Clause 4 adds new sections 14G to 14N to the principal Ordinance.
3. The new section 14G provides for the interpretation of terms used in the new provisions for the profits tax concessions, including the definitions of *qualifying aircraft leasing activity* and *qualifying aircraft leasing management activity*.
4. The new section 14H provides that a corporation that is a qualifying aircraft lessor for a year of assessment is entitled to have its profits derived from its qualifying aircraft leasing activity for that year of assessment charged at one-half the profits tax rate specified in Schedule 8 to the principal Ordinance (*concessionary rate*) (new section 14H(1)). That section also provides for how a corporation may be a qualifying aircraft lessor (new section 14H(2)) and how it can be entitled to the concessionary rate (new section 14H(4)).
5. The new section 14I provides that if the profits tax concession under the new section 14H applies to a corporation for a year of assessment, the net lease payments derived from its qualifying aircraft leasing activity are to be calculated in accordance with the formula set out in the new section 14I(2). The effect is that the taxable amount of the lease payments is to be equal to 20% of the tax base.
6. The new section 14J provides that a corporation that is a qualifying aircraft leasing manager for a year of assessment is entitled to have its profits derived from its qualifying aircraft leasing management activity for that year of assessment charged at the concessionary

rate (new section 14J(1)). The new section 14J(2) provides for how a corporation may be a qualifying aircraft leasing manager, namely—

- (a) by satisfying the conditions specified in the new section 14J(3);
- (b) by satisfying the safe harbour rule under the new section 14K; or
- (c) by obtaining the determination of the Commissioner of Inland Revenue (*Commissioner*) under the new section 14L.

The new section 14J(5) provides for certain conditions for the entitlement to the concessionary rate.

7. The new section 14K provides for how a corporation may satisfy the safe harbour rule. There are 2 alternative safe harbours as follows—
 - (a) the “1-year safe harbour” which requires the corporation to satisfy certain conditions regarding its aircraft leasing management profits and aircraft leasing management assets for the year of assessment concerned (new section 14K(2));
 - (b) the “multiple-year safe harbour” which requires the corporation to satisfy similar conditions for the year of assessment concerned and the preceding 1 or 2 years of assessment (new section 14K(3)).
8. The new section 14L provides for the Commissioner’s discretion to make a determination that a corporation, which is not otherwise qualified, is a qualifying aircraft leasing manager.
9. The new section 14M contains certain provisions for preventing avoidance of profits tax by means of the new profits tax concessions.

10. The new section 14N empowers the Commissioner to amend, by order published in the Gazette, the new Schedule 17F to the principal Ordinance (added by clause 15) which contains the definitions of *aircraft leasing activity* and *aircraft leasing management activity* and specifies the prescribed percentages relating to the calculation of net lease payments and the safe harbour rule.
11. Clause 5 amends section 15 of the principal Ordinance to add a new section 15(1)(n) to deem sums received by or accrued to a corporation from carrying on certain businesses in connection with aircraft as having a Hong Kong source, even if the aircraft are used outside Hong Kong.
12. Clause 6 consequentially amends section 19CA of the principal Ordinance so as to cover the trading receipts in respect of which assessable profits are chargeable to tax at the concessionary rate under the new section 14H or 14J.
13. Clause 7 makes a minor textual amendment to the English text of section 20AA of the principal Ordinance.
14. Clauses 8, 9, 10 and 11 amend sections 37, 38, 39B and 39D of the principal Ordinance respectively to deal with computation of the cost and capital expenditure in relation to an aircraft that is used by a corporation for carrying out a qualifying aircraft leasing activity before being used in another trade, profession or business.
15. Clause 12 makes a minor textual amendment to the Chinese text of section 80D of the principal Ordinance.
16. Clause 16 adds a new Schedule 41 to the principal Ordinance to deal with transitional matters.

Comparison between Onshore Aircraft Leasing and Offshore Aircraft Leasing

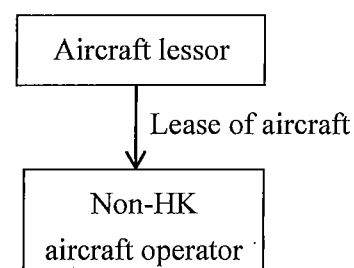
I. Before the proposed legislative amendments

Onshore aircraft leasing transaction



Profits tax rate	16.5%
Depreciation allowance	72% in Year 1 and 30% on reducing value basis thereafter
Tax payment	Tax liability arises upon disposal of the aircraft
Internal rate of return*	15.59%

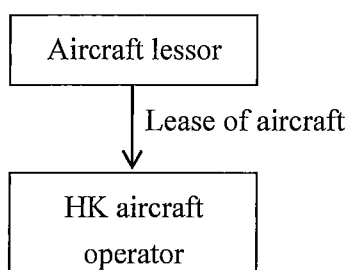
Offshore aircraft leasing transaction



Profits tax rate	16.5%
Depreciation allowance	Nil due to section 39E of the IRO
Tax payment	Tax upfront based on gross profits
Internal rate of return*	10.68%

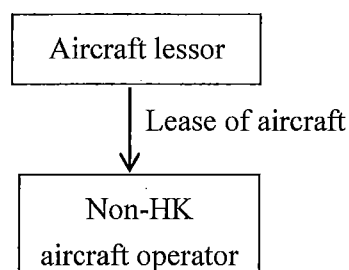
II. After the proposed legislative amendments

Onshore aircraft leasing transaction



Profits tax rate	16.5%
Depreciation allowance	72% in Year 1 and 30% on reducing value basis thereafter
Tax payment	Tax liability arises upon disposal of the aircraft
Internal rate of return*	15.59%

Offshore aircraft leasing transaction



Profits tax rate	8.25%
Depreciation allowance	Nil due to section 39E of the IRO
Tax base concession	20% of net lease payments
Tax payment	Tax upfront
Internal rate of return*	16.05%

Note*: The internal rates of return are calculated based on the following assumptions adopted by the Working Group on Transportation under Economic Development Commission:

- (1) Lease term: 12 years (2) Lease rate factor: 0.85 (3) Interest rate: 5%
 (4) Disposal value of aircraft after 12 years: 52% of aircraft cost