

立法會
Legislative Council

LC Paper No. CB(4)1539/16-17
(These minutes have been
seen by the Administration)

Ref : CB4/BC/4/16

Bills Committee on Inland Revenue (Amendment) (No. 2) Bill 2017

Minutes of the second meeting
held on Wednesday, 26 April 2017, at 9:00 am
in Conference Room 2 of the Legislative Council Complex

Members present : Hon Kenneth LEUNG (Chairman)
Hon James TO Kun-sun
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon Paul TSE Wai-chun, JP
Dr Hon KWOK Ka-ki
Hon Holden CHOW Ho-ding
Hon Jeremy TAM Man-ho

Members absent : Hon Charles Peter MOK, JP
Hon Dennis KWOK Wing-hang
Dr Hon Junius HO Kwan-yiu, JP

Member attending : Hon WU Chi-wai, MH

Public officers attending : Agenda item I
Transport and Housing Bureau

Mr Wallace LAU
Deputy Secretary for Transport and Housing
(Transport)⁴

Ms Candy NIP
Principal Assistant Secretary for Transport and
Housing (Transport)8

Financial Services and the Treasury Bureau

Mr Paul WONG
Principal Assistant Secretary for Financial
Services and Treasury (Financial Services)6

Inland Revenue Department

Mr CHIU Kwok-kit, JP
Deputy Commissioner (Technical)

Ms Michelle CHAN
Senior Assessor (Special Duties)

Department of Justice

Mr Henry CHAN
Senior Government Counsel

Mr Peter SZE
Senior Government Counsel

**Attendance by
invitation** : Agenda Item I

Berwin Leighton Paisner

Mr William HO Kai-kwong
Partner

Baker & McKenzie

Miss Carrie LUI
Registered Foreign Lawyer (New Zealand)

Allen & Overy LLP

Mrs Yvonne HO
Partner

The Association of Chartered Certified Accountants

Miss Anita TSANG
Member of Tax sub committee 16-17

Hong Kong Aircraft Leasing and Aviation Finance Association

Mr HUI Hon-chung
President

PricewaterhouseCoopers Limited

Mr LEUNG Ka-fai
Asset Finance & Leasing Services Tax Director

Deloitte Advisory (Hong Kong) Limited

Mr Jonathan CULVER
Partner

The Taxation Institute of Hong Kong

Mr Jeremy CHOI Heng-chio
Council member

Hong Kong Institute of Certified Public Accountants

Mr Edward LEAN
Member, Taxation Faculty Executive Committee

Clerk in attendance : Mr Daniel SIN
Chief Council Secretary (4)3

Staff in attendance : Ms Vanessa CHENG
Assistant Legal Adviser 5

Mr Ambrose LEUNG
Senior Council Secretary (4)3

Ms Peggy CHUNG
Council Secretary (4)3

Miss Mandy LAM
Legislative Assistant (4)3

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I. Meeting with deputations and the Administration

Submissions from deputations attending the meeting

- (LC Paper No. CB(4)886/16-17(01) -- Submission from Berwin Leighton Paisner dated 19 April 2017 (English version only)
- LC Paper No. CB(4)886/16-17(02) -- Submission from Hong Kong Aircraft Leasing and Aviation Finance Association dated 19 April 2017 (English version only)
- LC Paper No. CB(4)886/16-17(03) -- Submission from PricewaterhouseCoopers Limited dated 18 April 2017 (English version only)
- LC Paper No. CB(4)886/16-17(04) -- Submission from Deloitte Advisory (Hong Kong) Limited dated 19 April 2017 (English version only)
- LC Paper No. CB(4)886/16-17(05) -- Submission from Hong Kong Institute of Certified Public Accountants dated 20 April 2017 (English version only)
- LC Paper No. CB(4)886/16-17(10) -- Submission from The Taxation Institute of Hong Kong dated 21 April 2017 (English version only))

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Submissions from deputations not attending the meeting

- (LC Paper No. CB(4)886/16-17(06) -- Submission from Cathay Pacific Airways Limited dated 19 April 2017 (English version only)
- LC Paper No. CB(4)886/16-17(07) -- Submission from Hong Kong Dragon Airlines Limited dated 19 April 2017 (English version only)
- LC Paper No. CB(4)886/16-17(08) -- Submission from Hong Kong Airlines Limited dated 19 April 2017 (English version only)
- LC Paper No. CB(4)886/16-17(09) -- Submission from Hong Kong Exchanges and Clearing Limited dated 21 April 2017 (English version only)

Matters arising from previous meeting

- (LC Paper No. CB(4)894/16-17(01) -- List of follow-up actions arising from the discussion at the meeting on 11 April 2017
- LC Paper No. CB(4)894/16-17(02) -- Administration's response to the list of follow-up actions arising from the discussion at the meeting on 11 April 2017)

Other relevant papers

- (LC Paper No. CB(3)392/16-17 -- The Bill
- File Ref: THB(T)CR 1/44/951/08 -- Legislative Council Brief issued by the Transport and Housing Bureau and the Financial Services and the Treasury Bureau
- LC Paper No. LS49/16-17 -- Legal Service Division Report

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- LC Paper No. CB(4)822/16-17(01) -- Assistant Legal Adviser's letter dated 7 April 2017 to the Administration
- LC Paper No. CB(4)809/16-17(01) -- Marked-up copy of the Bill prepared by the Legal Service Division (Restricted to members)
- LC Paper No. CB(4) 809/16-17(02) -- Paper on Inland Revenue (Amendment) (No. 2) Bill 2017 prepared by the Legislative Council Secretariat (Background brief))

Discussion

The Bills Committee deliberated (Index of proceedings attached at **Annex**) and the key issues discussed are summarized in the ensuing paragraphs.

General remarks

2. Deputations generally supported the Administration's initiative to offer tax concession in respect of offshore aircraft leasing business transacted in Hong Kong. They agreed that the proposed tax regime would help attract aircraft leasing business to Hong Kong, and would promote economic growth and employment.
3. Some deputations suggested that the Administration should conclude more bilateral double taxation agreements with specific provisions to reduce withholding tax rates for corporations.

Definition of "non-Hong Kong aircraft operator"

4. Deputations noted that the tax concession under the Inland Revenue (Amendment)(No. 2) Bill 2017 ("the Bill") for the qualifying aircraft lessors and the qualifying aircraft leasing managers applied to the aircraft leasing activities and aircraft leasing management activities which qualify only if aircrafts were leased to a non-Hong Kong aircraft operator. They also noted that "Non-Hong Kong aircraft operator" was defined as an aircraft operator who was not chargeable to profits under the Inland Revenue Ordinance, Cap. 112.

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5. Most deputations commented on the definition of "non-Hong Kong aircraft operator." Some deputations sought clarification on whether an aircraft lessee would be considered as a "non-Hong Kong aircraft operator" and the lessor could enjoy the proposed tax concession if the leased aircraft called on Hong Kong for carriage of goods or passengers. Some suggested that a "non-Hong Kong aircraft operator" should include those exempt from profits tax under a bilateral double taxation agreement, while the Association of Chartered Certified Accountants suggested that "non-Hong Kong aircraft operator" should exclude those subject to tax in respect of the profits derived from air carriage activities in Hong Kong.

Funding lease

6. Some deputations noted that the proposed tax regime applied only to an operating lease and not a funding lease (so that there would be no transfer of asset ownership at the end of the lease). Deputations queried whether the restriction was necessary. Baker and McKenzie remarked that there was no such requirement in Singapore.

Capital expenditure and capital allowance

7. Deputations noted that the proposed section 14I in clause 4 of the Bill provided for the calculation of net lease payments on which the amount of tax would be based. In particular, the proposed section 14I(2) and section 2 of Part 2 of Schedule 17F (in clause 15 of the Bill) provided that the taxable net lease payments would be 20% of the difference between the total gross lease payments and the total deductible expenses. Section 14I(3)(a) provided that the calculation of the net lease payment based on the foregoing formula would not apply if the qualifying aircraft lessor had not incurred capital expenditure on the provision of the aircraft, and section 14I(3)(c) provided that the formula would also not be applicable if capital allowances were granted to a connected person of the lessor, 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.

8. Baker and McKenzie queried whether expenses incurred under a funding lease might be regarded as "capital expenditure" under section 14I(3)(a). It pointed out that the ownership of an aircraft might be transferred among different companies within the same group of companies. It was possible that a connected person (which could mean an associated corporation under the Bill) of a qualifying aircraft lessor might have incurred capital expenditure on the provision of the aircraft concerned and might have been granted capital allowance. Baker and McKenzie expressed concern

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that under such circumstances, the qualifying aircraft lessor might not be able to enjoy the tax concession under section 14I(2).

Qualifying aircraft leasing activity and qualifying aircraft leasing manager

9. The meeting noted that the proposed section 14G(6) in clause 4 of the Bill provided that one of the conditions for satisfying a qualifying aircraft leasing activity was one where the lessee was a non-Hong Kong aircraft operator.

10. The Association of Chartered Certified Accountants pointed out that some aircraft operators might set up special purpose vehicles ("SPVs") to which the lessor would lease the aircraft. The concerned SPV might further sublease the aircraft to an aircraft operator within the same group of companies. It suggested that the Administration should consider whether such arrangements would be regarded as a qualifying aircraft leasing activity for the purpose of the Bill.

11. Deputations noted that under the proposed sections 14G(7)(c), 14J(2) and 14J(3), a corporation would qualify as a "qualifying aircraft leasing manager" if it carried out qualifying aircraft leasing management activities. An aircraft leasing management activity would be a qualifying aircraft leasing management activity only if it met a number of criteria, including the condition that the qualifying aircraft leasing manager must perform the activity for another corporation and that corporation must be a qualifying aircraft lessor. However, a corporation would be a qualifying aircraft lessor only if it was not an aircraft operator. Section 1(1)(k) of Part 1 of the proposed Schedule 17F would apply only where a corporation provided finance to an airline enterprise and that airline enterprise was not an aircraft operator. The Hong Kong Institute of Certified Public Accountants pointed out that it was unlikely that a corporation that was an airline enterprise and required financing to purchase an aircraft would not also be an aircraft operator. It considered that some of the aircraft leasing management activities listed in section 1(1) of Part 1 of the proposed Schedule 17F (added by clause 15 of the Bill) could not be easily satisfied.

12. Paragraphs (c) and (d) under the definition of "aircraft leasing management activity" in section 1 of Schedule 17F provided that an aircraft leasing management activity included providing finance in obtaining the ownership of an aircraft by a special purpose entity, or providing a guarantee in respect of a financial or performance obligation as regards the aircraft leasing business of a special purpose entity. Deputations commented that the requirements were too restrictive and suggested that the requirements of

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the aircraft leasing management activities would be satisfied even if they had not set up such special purpose entities.

Grace period

13. Baker and McKenzie noted that an aircraft lessor might take time to establish its business in Hong Kong; it might not satisfy all the requirements to be a qualifying aircraft lessor on the first day of business in Hong Kong. The deputation suggested that the Administration should allow some flexibility in determining the eligibility of a corporation for the proposed tax concession under the Bill.

The Administration's initial response to deputation's views

14. The Administration responded that:

- (a) the definition of "non-Hong Kong aircraft operator" was intended to include all offshore aircraft operators which were not chargeable to profits tax in Hong Kong, whether or not under comprehensive double taxation agreements;
- (b) Departmental Interpretation and Practice Notes would be issued, if necessary, to explain and elaborate technicalities and implementation details following the passage of the Bill;
- (c) as regards the need to exclude a funding lease from the definition of "lease" in the Bill, the current drafting reflected the requirement that lessors' activities should have commercial substance under the international tax standards and the requirement to maintain consistency with the definition of "own" under section 14G(1); and
- (d) as regards whether the central management and control requirement would prevent a branch office of an overseas corporation in Hong Kong from profits enjoying the tax benefits under the Bill and was inconsistent with the non-discrimination article of tax treaties, concessionary tax measures were generally offered to resident companies in many tax jurisdictions. The requirement should not, however, be regarded as discriminatory against other overseas incorporated companies not resident in Hong Kong. In determining whether a branch office of an overseas corporation in Hong Kong could enjoy tax concessions in Hong Kong, it was necessary to consider the law and policy of

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the foreign jurisdiction which had entered bilateral tax treaty with Hong Kong and whether the law in foreign jurisdiction was consistent with the Hong Kong law. In practice, the competent authorities of the two tax jurisdictions concerned would resolve any disagreement through a dispute resolution mechanism provided under the tax treaty.

Discussion with the Administration

15. Some members expressed concern that a local corporation might set up companies overseas to own aircraft for conducting air transportation business in Hong Kong. The overseas company would not be subject to tax in Hong Kong. They queried whether the proposed legislation might create a loophole for tax avoidance. The Administration explained that under most bilateral tax treaties, an overseas aircraft operator would not be chargeable to profits tax in Hong Kong anyway. There would be no tax evasion or revenue loss arising from the implementation of the Bill, which did not relate to air transportation business.

16. A member commented that introducing the proposed tax regime would inevitably increase the overall number of aircraft trips. He said that there was an infrastructure and environmental cost to air traffic which might exceed the economic benefits arising from implementing the proposed tax regime.

17. The Administration explained that that the proposed tax regime was to promote development of aircraft leasing business in Hong Kong, which was not directly relevant to air traffic. The Administration added that part of the infrastructure and operating cost of the Hong Kong international Airport was covered by airport charges. Environmental measures were also introduced to reduce impact of air traffic on the neighbourhood.

Follow-up actions to be taken by the Administration

18. The Chairman requested the Administration to provide a written response to the deputation's views. He also invited the representative from PricewaterhouseCoopers ("PwC") to provide a copy of paper "Aviation Leasing: Leveraging Hong Kong's Strengths" published in 2015 for members' reference.

(Post-meeting note: (1) The English version and the Chinese version of Administration's response was issued to members vide LC Paper No. CB(4)1011/16-17(01) on 12 May 2017 and 14 August 2017 respectively; (2) The reports on "PwC Aviation Finance and Leasing

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Forum" and "Aviation Leasing – Leveraging Hong Kong's Strengths" published by PwC Hong Kong were circulated to members vide LC Paper No. CB(4)972/16-17(01) and (02) on 5 May 2017.)

Date of next meeting

19. The Chairman informed members that the third meeting would be held on 2 May 2017 at 10:45 am.

(Post-meeting note: On the advice of the Administration and with the concurrence of Hon Kenneth LEUNG, Chairman of the Bills Committee, the third meeting of the Bills Committee was re-scheduled for 8:30 am on Monday, 22 May 2017.)

II. Any other business

20. There being no other business, the meeting ended at 10:18 am.

Council Business Division 4
Legislative Council Secretariat
28 August 2017

**Proceedings of the second meeting of
Bills Committee on Inland Revenue (Amendment) (No. 2) Bill 2017
on Wednesday, 26 April 2017, at 9:00 am
in Conference Room 2 of the Legislative Council Complex**

Time marker	Speaker	Subject(s)	Action required
Agenda item I – Meeting with deputations and the Administration			
000000 – 000929	Chairman	Opening remarks	
000930 – 001153	Berwin Leighton Paisner	Presentation of views [LC Paper No. CB(4)886/16-17(01)]	
001154 – 001638	Baker & McKenzie	Presentation of views	
001639 – 001753	Allen & Overy LLP	Presentation of views	
001754 – 002038	The Association of Chartered Certified Accountants	Presentation of views	
002039 – 002532	Hong Kong Aircraft Leasing and Aviation Finance Association	Presentation of views [LC Paper No. CB(4)886/16-17(02)]	
002533 – 003007	PricewaterhouseCoopers Limited	Presentation of views [LC Paper No. CB(4)886/16-17(03)]	
003008 – 003413	Deloitte Advisory (Hong Kong) Limited	Presentation of views [LC Paper No. CB(4)886/16-17(04)]	
003414 – 003701	The Taxation Institute of Hong Kong	Presentation of views [LC Paper No. CB(4)886/16-17(10)]	
003702 – 004212	Hong Kong Institute of Certified Public Accountants	Presentation of views [LC Paper No. CB(4)886/16-17(05)]	
004213 – 004758	Chairman Administration	The Chairman invited the Administration to give an initial reply to the deputation's views and to provide a written response separately. The Administration responded to some of the key issues raised.	The Administration to follow up as per paragraph 18 of the minutes

Time marker	Speaker	Subject(s)	Action required
004759 – 005908	Chairman Dr KWOK Ka-ki Administration	Dr KWOK Ka-ki queried whether the proposed tax regime would create a loophole for tax evasion and he also queried on the other costs to Hong Kong arising from the Bill. The Administration responded to Dr KWOK's queries.	
005909 – 010530	Chairman Mr Jeremy TAM Man-ho Baker & McKenzie Administration	Representative from Baker & McKenzie responded to Mr Jeremy TAM's query about the suggestion for a "grace period" in implementing the Bill. The Administration responded to the representative's comments.	
010531 – 010755	Chairman Mr Jeremy TAM Man-ho Hong Kong Aircraft Leasing and Aviation Finance Association Administration	Mr Jeremy TAM asked whether any companies had approached the Hong Kong Aircraft Leasing and Aviation Finance Association and indicated interest in setting up aircraft leasing business in Hong Kong when the Bill was passed. The representative from the Hong Kong Aircraft Leasing and Aviation Finance Association responded.	
010756 – 011033	Chairman Administration	The Chairman sought clarification from the Administration on a point raised by the representative from the Hong Kong Institute of Certified Public Accountants on whether the proposed tax concession under the Bill could equally be available to a branch office of an overseas corporation in Hong Kong which is exempt from tax under the bilateral tax treaty entered into between Hong Kong and the non-resident jurisdiction. The Administration responded to the Chairman's query.	
011034 – 011116	Chairman PricewaterhouseCoopers Limited	The Chairman requested the representative from PricewaterhouseCoopers ("PwC") to provide a copy of "PwC Aviation Finance and Leasing Forum" and "Aviation Leasing – Leveraging Hong Kong's Strengths" for the Bills Committee's reference. The representative from PwC undertook to provide the documents after the meeting.	PwC to follow up as per paragraph 18 of the minutes

Time marker	Speaker	Subject(s)	Action required
011117 – 011800	Chairman Mr James TO Kun-sun PricewaterhouseCoopers Limited Berwin Leighton Paisner Hong Kong Aircraft Leasing and Aviation Finance Association Chairman	Mr James TO asked how the implementation of the proposed tax regime would improve Hong Kong's competitive advantage over its competitors and what other measures the Administration should introduce. Representatives from PricewaterhouseCoopers, Berwin Leighton Paisner and Hong Kong Aircraft Leasing and Aviation Finance Association responded to Mr James TO's queries.	
Agenda item II – Any other business			
011801 – 011907	Chairman Administration	Date of next meeting	