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Hon Kenneth Leung  
Chairman  
Bills Committee on the Inland Revenue (Amendment No. 2) Bill 2017  
Secretariat, Legislative Council  
Hong Kong SAR Government  
1 Legislative Council Road  
Central  
HONG KONG

18 April 2017

Dear Hon Kenneth Leung

**Comments on the Inland Revenue (Amendment No 2) Bill 2017 (The Bill)**

The Bill gazetted on 10 March 2017 amends the Inland Revenue Ordinance (IRO) (Cap 112) and creates a dedicated tax regime to attract aircraft leasing business to Hong Kong - creating a new professional services industry and creating jobs in Hong Kong.

On behalf of PricewaterhouseCoopers Limited (PwC Hong Kong), we summarise our observations and recommendations as follows:

**Overall Comments: Aircraft Leasing Business**

We would echo the Hong Kong Government's observation of the potential demand of new aircraft in the Mainland China in the next 20 years, which is estimated to be approximately US\$760 billion. Given Hong Kong's unique position to China, its prominent role as a business hub in the region, sophisticated financial markets, and well-developed legal system, international aircraft lessors looking to do more business in China naturally consider setting up base in Hong Kong. One of the policy measures set out in Circular No. 108 ("Opinions on Accelerating the Development of the Aircraft Leasing Industry") issued by the State Council of the People's Republic of China (国办法 [2013] 108号) was to make good use of Hong Kong's advantageous position as an international financial, trading and transportation centre, and encourage aircraft leasing companies to set up operations in Hong Kong. However, the current Hong Kong tax rules on aircraft leasing make Hong Kong an unattractive location for aircraft leasing companies to do this. In order to make Hong Kong more competitive in this space, *we welcome the Government's decision to create a dedicated tax regime to improve the overall business environment for aircraft lessors operating in Hong Kong. This will not only help Hong Kong maintain its competitiveness as Asia's key transportation and business hub, but also strengthen its position as a major international financial centre.*

We would like to comment that any such revision of tax rules should not result in tax losses to Hong Kong, and developing Hong Kong into an aircraft leasing, financing and investment centre should not require any Hong Kong Government subsidy.

According to the research paper entitled "*Aviation Leasing: Leverage Hong Kong's Strengths*" published by PwC Hong Kong in 2015, we estimated that the number of aircraft to be managed in Hong Kong would be over 3,000 with a value of approximately US\$91 billion in the next 20 years based on the number of new aircraft required globally from the aircraft manufacturers. Aircraft leasing is not just an asset financing business. It also demands an in-depth understanding of the various segments of the global aviation business. The business is knowledge-intensive and global in nature. Business executives in the aircraft leasing industry have to build up global connections and business ties with people along the whole

supply chain of aviation and aerospace industries. The establishment of Hong Kong as an important aircraft leasing centre will therefore help to promote and consolidate Hong Kong's position as a global business and financial centre, and to create job positions for the future generations.

### **Specific Comments on the Bill**

Our understanding of the key features of the Bill is as follows:

- a) the tax rate on the qualifying profits of the qualifying aircraft lessors and qualifying aircraft leasing managers will be half of the corporation tax rate i.e. 8.25%; and
- b) the taxable amount of rentals 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 rentals less deductible expenses (excluding tax depreciation).

Although there will be no tax depreciation available for a qualifying aircraft lessor under the proposed tax regime, the tax base is correspondingly reduced to 20%. Whilst it is a common feature in many jurisdictions where tax depreciation is normally available on capital expenditure incurred for the purposes of a trade, the proposed tax regime is innovative and the proposed regime will be competitive compared to other countries.

The anti-abuse features incorporated in the dedicated tax regime in order to maintain the integrity of the tax framework including the requirement of "central management and control" as well as "profits generating activities" in Hong Kong should be acceptable and would play an important part of the proposed tax regime to be anti-BEPS (Base Erosion and Profits Shifting) compliant.

*We are of the view that the proposed tax regime is a significant improvement over the existing tax provisions, and should be welcome by the aircraft leasing community.* However, there are certain aspects of the Bill which may require *further clarifications* in order to ensure aircraft lessors can operate their businesses based on their commercial requirements including:

- a) As special purpose vehicles (SPVs) are normally being used for aircraft leasing, confirmation from the Inland Revenue Department (IRD) that it will adopt a wider approach in practice to determine whether the SPVs are considered to be "centrally managed and controlled" and performing "profits generating activities" in Hong Kong is needed. We believe the aircraft leasing industry would welcome some practical guidance from the IRD on this aspect.
- b) Section 23D(1) deemed "an owner of aircraft" e.g. a non-Hong Kong aircraft operator to be carrying on a business in Hong Kong if any aircraft owned by that person lands at any aerodrome or airport within Hong Kong. "Owner" includes a charterer of the aircraft under a charter-party. To the extent that the non-Hong Kong aircraft operator derives any relevant sum under Section 23D(1), it should be subject to profits tax at 16.5%. Therefore, it seems that an aircraft lessor may not qualify if a non-Hong Kong aircraft operator uses the aircraft in Hong Kong. It would be useful for the IRD to provide practical guidance on this particular issue including the interaction of Section 23D(1) and the double tax treaties and airline and shipping income agreements concluded by Hong Kong.
- c) The requirement of a certificate of resident (COR) of a lessor is normally a condition precedent under a leasing transaction. The aircraft leasing industry would welcome some practical guidance from the IRD to apply for a COR and to allow an aircraft lessor to obtain a COR in a timely and efficient manner.



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- d) It is a common business practice for airline operators to request an aircraft lessor to lease an aircraft to a “group entity” (which is not an aircraft operator itself), which in turn will lease the aircraft to another group company which is an aircraft operator. We would like to seek clarification from the IRD that the aircraft lessor should still be able to fall within the proposed tax regime provided that it satisfies the other conditions required even though it follows the normal business practice of the airline operators and leases an aircraft to an aircraft operator “indirectly”.
- e) There may be other “income” or “expenses” generated in an aircraft leasing and aircraft leasing management businesses including interest income, gains and losses arising from interest rate and foreign exchange swaps, termination payments, commissions etc. We would like the IRD to clarify such incidental income or expenses arising from other activities other than leasing should also fall under the proposed tax regime provided that they are part and parcel of the qualifying activities carried on by the aircraft lessors or aircraft leasing managers.
- f) Another activity which may be carried on by an aircraft leasing manager may be providing advice to aircraft lessors in relation to disposals of aircraft. We would like the IRD to clarify that this activity or any related activities will be treated as qualifying leasing management activities for the purpose of the tax regime.

We believe that the Bill will provide a suitable platform for aircraft lessors considering to set up in Asia. It is, however, important for the Hong Kong SAR Government to provide the necessary support and to engage in dialogue with the aircraft leasing and financing communities to deal with any future changes in the industry. Additionally, we would ask the Hong Kong SAR Government to further broaden its double tax treaty network and to ensure any withholding tax imposed by the tax treaty partners on lease rentals for equipment be reduced to “nil” or “the lowest rate possible” in order to further develop asset finance and leasing business in Hong Kong.

If you would like to discuss any of the specific comments in our submission please do not hesitate to contact us at [reynold.hung@hk.pwc.com](mailto:reynold.hung@hk.pwc.com) or [clarence.kf.leung@hk.pwc.com](mailto:clarence.kf.leung@hk.pwc.com)

Yours sincerely  
For and on behalf of PricewaterhouseCoopers Ltd.

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