

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

Draft Committee Stage Amendments proposed by the Government

Purpose

The Government proposes to introduce Committee Stage Amendments (“CSAs”) to the Inland Revenue (Amendment) (No. 2) Bill 2017 (“the Bill”) in response to:

- (a) the latest requirement of the Organisation for Economic Co-operation and Development (“OECD”) in relation to harmful tax practices; and
- (b) the submissions from the deputations.

This paper invites Members to consider the draft CSAs.

Latest Requirement of OECD

2. OECD and the Group of Twenty released a package of 15 actions to combat base erosion and profit shifting (“BEPS”) in October 2015. BEPS refers to tax planning strategies of multinational enterprises that exploit the gaps and mismatches in tax rules among economies to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid. Hong Kong indicated to OECD in June 2016 its commitment to implementing the BEPS package.

3. Countering harmful tax practices is one of the four minimum standards of the BEPS package¹. The Forum on Harmful Tax Practice (“FHTP”), a working party under OECD, is responsible for reviewing the preferential tax regimes relating to income from geographically mobile activities (such as financial and other service activities) of all participating jurisdictions. In determining whether a preferential tax regime is potentially harmful, FHTP would take into account a number of factors, one of which is that “the regime is ring-fenced from the domestic economy”.

4. In March, we were informed that FHTP would adopt a rigid and

¹ The four minimum standards include countering harmful tax practice (Action 5), preventing treaty abuse (Action 6), imposing country-by-country reporting requirement (Action 13) and introducing dispute resolution mechanism (Action 14).

narrow interpretation on the “ring-fencing” factor when determining whether a preferential tax regime was potentially harmful. Failure to address OECD’s concerns about harmful tax practices will jeopardize Hong Kong’s reputation as an international financial centre. Meanwhile, the European Union (“EU”) has kicked off an exercise to draw up a list of “non-cooperative tax jurisdiction” by the end of 2017 and the existence of harmful tax measures is one of its concerns². A jurisdiction listed as “non-cooperative” could be subject to defensive measures which will make it a less attractive place for investment and business.

5. Given the latest development, we consider it prudent for Hong Kong to revise the proposed aircraft leasing regime so that there will not be a perception issue on ring-fencing as the proposed tax regime would only be made applicable for offshore aircraft leasing activities.

Submissions from Deputations

6. At present, companies leasing aircraft to a Hong Kong aircraft operator (i.e. onshore aircraft leasing activities) are entitled under the Inland Revenue Ordinance (Cap. 112) (“IRO”) to obtain depreciation allowance in respect of the subject aircraft (i.e. referred to as **Scheme A** hereafter).

7. On the other hand, the proposed aircraft leasing regime under the Bill (i.e. referred to as **Scheme B** hereafter) aims to provide profits tax concessions in respect of offshore aircraft leasing activities. That is, to be eligible for the proposed profits tax concessions, the lessor’s aircraft must be leased to a “non-Hong Kong aircraft operator”, which does not include local aircraft operators and offshore aircraft operators having aircraft flying to Hong Kong.

8. Nevertheless, the industry stakeholders have some concerns on the above “non-Hong Kong aircraft operator” requirement. They commented that the proposed aircraft leasing regime would only cover non-resident aircraft operators carrying on business outside Hong Kong and those covered by Hong Kong’s double taxation agreements and air services/shipping income agreements. Leasing of aircraft to an offshore aircraft operator in a non-treaty partner jurisdiction having aircraft flying to Hong Kong could not be eligible for the proposed profits tax concessions. As Hong Kong’s treaty network is comparatively limited at present, this requirement would make the proposed aircraft leasing regime less attractive. They hope that the regime could cover all offshore aircraft operators.

² EU will adopt three criteria in the screening process, namely (a) tax transparency; (b) fair taxation; and (c) implementation of anti-BEPS measures. In terms of fair taxation, the jurisdiction concerned should not have any preferential tax measures that are regarded as harmful by FHTP.

Committee Stage Amendments

9. In view of the latest development in OECD and the submissions from the deputations, we propose to introduce the draft CSAs at **Annex A** so as to extend the proposed tax regime for offshore aircraft leasing activities under the Bill to onshore aircraft leasing activities as well. Under this revised tax regime, companies engaging in onshore aircraft leasing activities will be assessed under Scheme A by default. Alternatively, they may elect for assessment under Scheme B. The election, once made, is irrevocable. Meanwhile, companies engaging in offshore aircraft leasing activities will remain entitled to Scheme B only. A table summarising the tax assessment options under the proposed CSAs is at **Annex B**.

Assessment of Stakeholders' Views

10. As stated in our Legislative Council Brief for the Bill (Ref: THB(T)CR 1/44/951/08), the Government has consulted local airlines on the original dedicated tax regime (i.e. only for off-shore aircraft leasing business) and all of them were supportive of the proposal. The proposed CSAs will provide all local airlines an additional option for their taxation arrangement. They can compare the pros and cons of Scheme A and Scheme B in accordance with their own business consideration/strategy and elect for assessment under the new tax regime or remain under the existing assessment arrangement by their own discretion. As such, we do not expect any objection from them.

Advice Sought

11. Members are invited to note and comment on the draft CSAs.

May 2017

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

Committee Stage

Amendments to be moved by the Secretary for Transport and Housing

<u>Clause</u>	<u>Amendment Proposed</u>
4	In the proposed section 14G(1), by deleting the definition of <i>non-Hong Kong aircraft operator</i> .
4	In the proposed section 14G(6)(b), by deleting “, and is leased to a non-Hong Kong aircraft operator,”.
4	In the proposed section 14G(7)(d), by deleting “a non-Hong Kong” and substituting “an”.
4	In the proposed section 14H(1), by deleting “(4), (6) and (7)” and substituting “(4) and (6)”.
4	By deleting the proposed section 14H(7) and substituting— “(7) If subsection (1) applies to a corporation for a year of assessment, the corporation is not entitled to be granted any allowance under Part 6 for that year of assessment in respect of the capital expenditure incurred on the provision of the aircraft concerned.”.
4	By deleting the proposed section 14I(3)(b) and substituting— “(b) allowances under Part 6 have been granted to the corporation or a connected person of the corporation in respect of the capital expenditure incurred on the provision of the aircraft concerned; or”.

4 In the proposed section 14I(4), by deleting “a non-Hong Kong” and substituting “an”.

4 In the proposed section 14J(1), by deleting “(5), (7) and (8)” and substituting “(5) and (7)”.

4 By deleting the proposed section 14J(8) and (9).

4 By deleting the proposed section 14M(5), (6) and (8).

New By adding—

“5A. Section 16 amended (ascertainment of chargeable profits)

After section 16(1)—

Add

“(1A) In computing the amount of deduction of a person’s outgoings and expenses for the purposes of subsection (1), if—

- (a) the person is a connected person (as defined by section 14G(1)) of a corporation;
- (b) a sum is payable by the person to the corporation, whether directly or through an interposed person; and
- (c) the sum is included in the assessable profits of the corporation chargeable at a reduced tax rate under section 14H(1) or 14J(1) for a year of assessment,

the amount of deduction in respect of the sum is to be reduced such that the profits tax payable by the person is increased by reference to the amount of the reduction in the profits tax payable by the corporation

in respect of the sum for the year of assessment or any subsequent year of assessment.”.”.

8 In the proposed section 37(2B), by adding “in respect of which section 14H(1) applies” after “activity”.

10(2) In the proposed section 39B(6A), by adding “in respect of which section 14H(1) applies” after “activity”.

**Summary of Tax Assessment Options under
the Proposed CSAs**

	Lease to <u>HK</u> Aircraft Operators	Lease to <u>non-HK</u> Aircraft Operators
Tax Assessment under the Existing Bill	Scheme A (<i>i.e. current tax treatment under the Inland Revenue Ordinance</i>) ✓ depreciation allowance × 20% taxable base × half rate	Scheme B (<i>i.e. proposed tax regime under the Bill</i>) × depreciation allowance ✓ 20% taxable base ✓ half rate
Tax Assessment Options under the Proposed CSAs	Lessors are assessed under Scheme A by default – Scheme A: ✓ depreciation allowance × 20% taxable base × half rate Alternatively, they may elect for assessment under Scheme B – Scheme B: × depreciation allowance ✓ 20% taxable base ✓ half rate	Same as above (<i>i.e. Scheme B only</i>)