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26 May 2017

Mr Daniel Sin
Clerk to Bills Committee
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong
[By Fax: 3151 7052]

Dear Mr Sin,

Inland Revenue (Amendment) (No.2) Bill 2017
The Administration's responses to Mr Wilson Kung's questions

I refer to your email dated 24 May 2017.

The finance lease issue raised by Mr Wilson Kung in his email dated 23 May 2017 has been explained in our letter issued to the Bills Committee on 10 May 2017 (see pages 4 to 6 in LC Paper No. CB(4)1011/16-17(01)). To address Mr Kung's concerns, we are delighted to provide the explanations once again.

The definition of "lease" does not include a funding lease (similar to a finance lease), hire-purchase agreement or conditional sale agreement. This is to align with the ownership concept in the amendment bill. These three types of arrangements are commonly

adopted by aircraft lessors when acquiring aircraft. That said, the word “own” is defined to include all these three arrangements. Therefore, a qualifying aircraft lessor holding an aircraft as a lessee under a funding lease, as a bailee under a hire-purchase agreement or as a buyer under a conditional sale agreement will be regarded as the owner of the aircraft and is eligible for the proposed profits tax concessions under this aircraft leasing regime. Under such definition, if a qualifying aircraft lessor leases an aircraft to an aircraft operator under a funding lease, a hire-purchase agreement or a conditional sale agreement, the qualifying aircraft lessor should no longer be regarded as the owner of the aircraft. In such a case, the aircraft operator becomes the owner and the lease transaction is not a “qualifying aircraft leasing activity” which requires the qualifying aircraft lessor to “own” the aircraft.

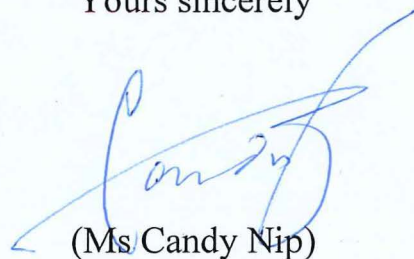
The above ownership requirement is necessary so as to ensure compliance with the international standards to combat base erosion and profit shifting (BEPS). The qualifying aircraft lessor is expected under the standards to have substantial activities in Hong Kong, performing the relevant functions, using the relevant assets and assuming the relevant risks associated with the ownership of the aircraft.

Mr Kung rightly pointed out that operating lease and finance lease are treated no differently under lessee accounting. Thus, HKFRS 16 should not be relevant. While an aircraft operator or a lessee could not claim depreciation allowances or deduction in respect of the aircraft under an operating lease (i.e. right-of-use asset), the rentals paid to the qualifying aircraft lessor can be fully tax deductible. For a qualifying aircraft lessor, depreciation allowances will be granted if the aircraft is leased to a Hong Kong aircraft operator. Alternatively, the profits tax concessions proposed in the bill can be obtained upon election by the qualifying aircraft lessor.

Turning to the drafting question, the provisions in the new section 14G(3) and (4) should be read together. The words "that definition" mentioned in the new section 14G(4)(a) and (b) refer to the definition of "funding lease" in the new section 14G(1). Under that definition, paragraphs (a)(ii) and (iii) set out the criteria under which a dry lease would be treated as a funding lease.

The Inland Revenue Department is ready to provide further explanations regarding the aircraft leasing regime in a Departmental Interpretation and Practice Note which is now under preparation.

Yours sincerely



(Ms Candy Nip)

for Secretary for Transport and Housing

c.c.

Financial Services and the Treasury Bureau (Attn: Mr Paul Wong)

Inland Revenue Department (Attn: Mr KK Chiu)

Department of Justice (Attn: Mr Henry Chan)