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Legal Service Division Report on Inland Revenue (Amendment) (No. 2) Bill 2017

I. SUMMARY

1. **The Bill**	The Bill seeks to amend the Inland Revenue Ordinance (Cap. 112) to give effect to a tax concession proposal announced in the 2017-2018 Budget by giving 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.
2. **Public Consultation**	According to the Legislative Council Brief, the proposed dedicated tax regime for aircraft leasing business was developed in consultation with the Economic Development Commission and the Working Group on Transportation ("TWG") under it. The Administration has incorporated technical input from the Focus Group on Promoting Aerospace Financing in Hong Kong under TWG, in which aviation industry stakeholders, legal professionals and consultants specializing in large asset financing are represented. Local airlines are supportive of the proposal.
3. **Consultation with LegCo Panel**	As advised by the Clerk to the Panel on Economic Development, the Panel was consulted on the legislative proposal to amend Cap. 112 to create a dedicated tax regime to attract aircraft leasing business to Hong Kong at its meeting on 23 January 2017. Members generally supported the proposal and urged for its early implementation.
4. **Conclusion**	The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. In view of the implications of the Bill on the profits tax system, members may wish to form a Bills Committee to study the Bill in detail.

II. REPORT

The date of First Reading of the Bill is 22 March 2017. Members may refer to the Legislative Council ("LegCo") Brief (File Ref.: THB(T)CR 1/44/951/08) issued by the Transport and Housing Bureau and the Financial Services and the Treasury Bureau on 8 March 2017 for further details.

Object of the Bill

2. The Bill seeks to amend the Inland Revenue Ordinance (Cap. 112) 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.

Background

3. Under the current tax regime, profits of a corporation arising in or derived from Hong Kong from carrying on an aircraft leasing business in Hong Kong are chargeable to profits tax at the current rate of 16.5%[1] (as specified in Schedule 8 to Cap. 112). The Financial Secretary announced in the 2017-18 Budget that the Government would introduce a bill to amend Cap. 112 to offer tax concessions to attract aircraft leasing companies to develop their business in Hong Kong. According to paragraph 8 of the LegCo Brief, the Administration proposes to introduce profits tax concessions for qualifying aircraft lessors and qualifying aircraft leasing managers to foster a more conducive environment for offshore aircraft leasing transactions in Hong Kong so as to enhance the status of Hong Kong as an international financial centre and Hong Kong's soft power as an international aviation hub.

Provisions of the Bill

4. The Bill seeks to amend Cap. 112 to give profits tax concessions to qualifying aircraft lessors and qualifying aircraft leasing managers. The major provisions are summarized in the following paragraphs.

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[1] Under section 14(1) of Cap. 112, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with Part 4 of Cap. 112. Assessable profits of a corporation are taxed at the current standard rate of 16.5% as specified in Schedule 8 to Cap. 112.

Concessionary tax regime for qualifying aircraft lessors and qualifying aircraft leasing managers

5. The Bill seeks to provide for a regime in which the tax rate on the qualifying profits of qualifying aircraft lessors and qualifying aircraft leasing managers derived from qualifying aircraft leasing activity and qualifying aircraft leasing management activity respectively would be 50% of the prevailing profits tax rate for corporations as specified in Schedule 8 to Cap. 112 (i.e. 16.5% x 50% = 8.25%) (new sections 14H(1) and 14J(1)).

6. For the purposes of the computation of the assessable profits of a qualifying aircraft lessor under the new section 14H(1), the net lease payments derived from its qualifying aircraft leasing activity are proposed to be calculated in accordance with the formula in the new section 14I(2). The effect is that the taxable amount of lease payments derived from qualifying aircraft leasing activity would be equal to 20% (the prescribed percentage in Part 2 of the new Schedule 17F) of the tax base, i.e. gross lease payments less deductible expenses (excluding tax depreciation).

Eligibility as a qualifying aircraft lessor

7. To be eligible as a qualifying aircraft lessor, a corporation needs to satisfy the following conditions proposed in new section 14H(2):

(a) it is not an aircraft operator;

(b) it has carried out in Hong Kong one or more qualifying aircraft leasing activities as defined in the new section 14G(6); and

(c) it has not carried out in Hong Kong any activity other than a qualifying aircraft leasing activity as defined in the new section 14G(7).

Eligibility as a qualifying aircraft leasing manager

8. The new sections 14J, 14K and 14L seek to provide for the circumstances under which a corporation may be qualified as a qualifying aircraft leasing manager. To be eligible as a qualifying aircraft leasing manager, a corporation should not be an aircraft operator and needs to satisfy one of the following conditions:

(a) it has carried out in Hong Kong one or more qualifying aircraft leasing management activities and has not carried out in Hong Kong any activity other than a qualifying aircraft leasing management activity (new section 14J(3));

(b) it satisfies the safe harbour rule under which the corporation is required to fulfill certain conditions regarding its aircraft management profits and aircraft leasing management assets for the year of assessment concerned under the "1-year safe harbour" (new section 14K(2)), or for the year of assessment concerned and the preceding one or two years of assessment under the "multi-year safe harbour" (new section 14K(3)); or

(c) it has obtained a determination of the Commissioner of Inland Revenue ("the Commissioner") that the corporation, which is not otherwise qualified, is a qualifying aircraft leasing manager if the Commissioner is of the opinion that the relevant conditions in (a) or the safe harbor rule in (b) above would, in the ordinary course of business, have been satisfied for the year of assessment concerned (new section 14L).

<u>Other provisions</u>

9. Other provisions of the Bill relate to consequential amendments, anti-avoidance provisions, transitional matters and minor textual amendments.

Commencement

10. The Bill, if passed, would come into operation on the day on which it is published in the Gazette.

Public Consultation

11. According to paragraph 25 of the LegCo Brief, the proposed dedicated tax regime for aircraft leasing business was developed in consultation with the Economic Development Commission and the Working Group on Transportation ("TWG") under it. The Administration had incorporated technical input from the Focus Group on Promoting Aerospace Financing in Hong Kong under TWG, in which aviation industry stakeholders, legal professionals and consultants specializing in large asset financing are represented. Some aircraft leasing companies indicated that they are interested in making use of Hong Kong as a platform to enter into Mainland and Asia markets. Local airlines are supportive of the proposal.

Consultation with LegCo Panel

12. According to the Clerk to the Panel on Economic Development, the Panel was consulted on the legislative proposal to amend Cap. 112 to create a dedicated tax regime to attract aircraft leasing business to Hong Kong at its meeting on 23 January 2017. Members generally supported the proposal to strengthen the

development of offshore aircraft leasing activities in Hong Kong and urged for its early implementation. To ensure sufficient manpower support for the development of this specialized business in Hong Kong, members called on the Administration to strengthen the relevant manpower resources. Some members also urged the Administration to consider providing similar tax incentive schemes to the maritime industry and local enterprises.

Conclusion

13. The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. In view of the implications of the Bill on the profits tax system, members may wish to form a Bills Committee to study the Bill in detail.

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