

Concessionary Tax Regime to Boost Aircraft Leasing Industry in Hong Kong

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On 10th March 2017 the Hong Kong Government gazetted the "Inland Revenue (Amendment) (No.2) Bill 2017"¹(hereinafter "the Bill") to introduce a concessionary tax regime for aircraft leasing industry. The main content of the Bill will be illustrated below.

BACKGROUND

Civil aviation industry has been sustainably growing and is anticipated to be in great demand in the long run. Reports over aviation industry have forecast the annual growth in passenger traffic at an average rate of approximately 5% in globe and 6% in Asia Pacific region, during the next 20 years. Similarly, it is estimated that until 2035, the number of new civil aircrafts will be 39,000(valued at US\$ 5.9 trillion) globally and 15,000(valued at US\$240 million) in Asia Pacific region, in which the demand from Mainland China accounts for over 40%.

On the other hand, aircraft financing market is expanding at a fast-speed meanwhile. In 2016, new aircrafts deliveries achieved US\$ 122 Billion and anticipated to increase to US\$ 185 Billion by 2021 if the fundamentals of global aviation industry continue to steadily drive growth in funding needs. Moreover, the proportion of new aircraft being financed by leasing is forecast to be over 40% in the future, which draws attention among aviation leasing market.

However, there is currently not a strong presence of aircraft leasing business in Hong Kong. When leasing to non-Hong Kong based airlines, Hong Kong lessor is generally taxed on any lease revenue without being entitled to claim tax depreciation on the acquisition cost of the aircraft.

To address the issues mentioned above and enhance competitiveness of Hong Kong as a premium aircraft leasing hub, the concessionary tax regime is proposed in the Budget 2017-2018. Hong Kong is fully equipped itself with favourable conditions to develop aircraft leasing business. The solid law regime and banking system, diversified capital market, excellent aircraft infrastructure as well as abundant talents, are highly expected to further support its aircraft leasing business.

HIGHLIGHTS

Separate concessionary tax regimes are respectively introduced to serve qualifying aircraft lessors and qualifying aircraft leasing managers in the Bill. For those who want to enjoy the regime, prior application is not needed and what needs to be done is simply adopt the concessionary tax rate when submitting the tax return. However, if the

1. Inland Revenue (Amendment) (No. 2) Bill 2017
<http://www.legco.gov.hk/yr16-17/english/Bills/b201703101.pdf>

applicant fails to qualify for a particular year, the preferential tax rate will not be applicable for the year of assessment and the subsequent year of assessment.

The concessionary tax regimes on the Bill are as follows:

(1) The concessionary tax regime for qualifying aircraft lessors

The concessionary tax regime for qualifying aircraft lessors		
Contents	For the qualifying aircraft lessors, a concessionary profits tax rate for qualifying profits derived from its qualifying aircraft leasing activities (leasing an aircraft owned by the qualifying aircraft lessor to a non-Hong Kong aircraft operator) shall be decreased 50%. (From 16.5% to 8.25%)	
Calculation Of Qualifying Profits	<p><u>Qualifying Profits=(A-B)×C</u></p> <ul style="list-style-type: none"> ▪ A means the aggregate amount of the gross lease payments based on dry lease. Dry lease means the lease satisfied conditions below but excluding a funding lease, hire-purchase agreement or conditional sale agreement. <ul style="list-style-type: none"> ✓ An aircraft is bona fide demised, let or hired out, or a right to use an aircraft is otherwise granted, by a person(lessor) to another person for a term exceeding 1 year; ✓ The lessor is not responsible for ensuring the airworthiness of the aircraft; and ✓ No member of the crew of the aircraft is employed by the lessor; ▪ B means the aggregate amount of any outgoings and expenses deductible (excluding tax depreciation). ▪ C means 20% 	
Applicable Conditions	Qualification	<ul style="list-style-type: none"> ▪ The central management and control of the corporation is exercised in Hong Kong; ▪ The activities that produce its qualifying profits in that year are carried out in Hong Kong by the corporation; or arranged by the corporation to be carried out in Hong Kong; and ▪ Those activities are not carried out by a permanent establishment outside Hong Kong.
	Business Conditions	<ul style="list-style-type: none"> ▪ It is not an aircraft operator; ▪ It has carried out in Hong Kong one or more qualifying aircraft leasing activities; and ▪ It has not carried out in Hong Kong any activity other than a qualifying aircraft leasing activity.
Applicable Scope	The concessionary profits tax rate for qualifying aircraft lessors will apply to relevant profits accrued on or after 1 April 2017	

(2) The concessionary tax regime for qualifying aircraft leasing managers

The concessionary tax regime for qualifying aircraft leasing managers		
Contents	For the qualifying aircraft leasing managers, a concessionary profits tax rate for assessable profits derived from its qualifying aircraft leasing management activities (the management activities carried out for a qualifying aircraft lessor in respect of qualifying aircraft leasing activities, refer to Appendix) shall be decreased 50%. (From 16.5% to 8.25%)	
Calculation	Assessable Profits = Gross revenue by carrying out aircraft leasing management activities – Gross deductible expenses	
Applicable Conditions	Qualification	<ul style="list-style-type: none"> ▪ The central management and control of the corporation is exercised in Hong Kong; ▪ The activities that produce its qualifying profits in that year are carried out in Hong Kong by the corporation; or arranged by the corporation to be carried out in Hong Kong ;and ▪ Those activities are not carried out by a permanent establishment outside Hong Kong

	Business Conditions	<p>Corporations (excluding aircraft operator) satisfy any of the following conditions:</p> <p>① It has carried out one or more aircraft leasing management activities in Hong Kong and has not carried out any other activities in Hong Kong ;</p> <p>② It satisfies the specified safe harbour rule as (i) or (ii) discussed below;</p> <p>i. The 1-year safe harbour</p> <ul style="list-style-type: none"> ▪ The ratio between the total aircraft leasing management profits(ALMP) and the total profits (regardless of the source of the profits) accruing to the corporation in the basis period of the year of assessment concerned is not lower than 75% and ▪ The ratio between the total value of the aircraft leasing management assets (ALMA) and the total value of all assets (regardless of the location of the assets concerned) of the corporation at the end of the basis period for the year of assessment concerned is not lower than 75%;or <p>ii. The multiple-year safe harbour</p> <ul style="list-style-type: none"> ▪ The average ratio between the total aircraft leasing management profits(ALMP) and the total profits(regardless of the source of the profits)accruing to the corporation in the basis period of the year of assessment concerned is not lower than 75% and ▪ The average ratio between the total value of the aircraft leasing management assets (ALMA) and the total value of all assets(regardless of the location of the assets concerned)of the corporation at the end of the basis period for the year of assessment concerned is not lower than 75%; <p>③ It has obtained the Commissioner’s determination that the corporation is a qualifying aircraft leasing management company</p>
Applicable Scope	The concessionary profits tax rate for qualifying aircraft leasing managers will apply to relevant profits accrued on or after 1 April 2017	

COMMENTS

Featured as “8.25% plus 20%”, the tax concession for qualifying aircraft lessors should make Hong Kong an attractive location for setting up an aircraft leasing hub as compared to others. According to professional’s simulation, the effective profits tax rate is speculated from 3% to 4% even if excluding the tax depreciation on the acquisition cost of aircraft, which is lower than 5%/10% of Singapore or 12.5% of Ireland. Meanwhile, another attraction of the Bill refers to that the capital gain of disposing aircrafts is not subject to taxation (if the aircraft owned by a corporation has been used by the corporation for carrying out a qualifying aircraft leasing activity for a continuous period of not less than 3 years).

In usual, it is necessary to consider the withholding tax rate on lease rentals derived from offshore aircraft leasing activities. The withholding tax rate is set to be 5% when leasing aircraft to mainland aircraft operators based on the Double Taxation Agreement between Mainland and Hong Kong, which is preferential than 6% between mainland and Singapore or Ireland. However, the country number of signing Comprehensive Double Taxation Agreements (CDTAs) for Hong Kong, Singapore and Ireland is respectively 36, 84 and 72, which may bring out unfavourable factor towards Hong Kong’s aircraft leasing business.

To sum up, the Bill introduces a significant advantage for aircraft leasing lessors and managers who target on Mainland China’s huge market, offering a higher incentive for those who carry out business in Hong Kong. We are hoping the bill will be taken into force early, and we will keep watching related movement of it.

【Appendix】

Aircraft Leasing Management Activity

Aircraft leasing management activity, in relation to a corporation, means any of the following activities:

- a) Managing another corporation that is a relevant qualifying aircraft lessor;
- b) Establishment or administration of a special purpose entity for the purpose of owning an aircraft by that entity;
- c) Providing finance in obtaining the ownership of an aircraft by a special purpose entity wholly or partly owned by the corporation or its associated corporation;
- d) Providing a guarantee in respect of a financial or performance obligation as regards the aircraft leasing business of a special purpose entity wholly or partly owned by the corporation or its associated corporation, or granting security in respect of that business;
- e) Managing leases;
- f) Arranging for the procurement or leasing of aircraft;
- g) Arranging for the operation, maintenance, repair, insurance, storage, scrapping or modification of aircraft;
- h) Arranging for the evaluation, appraisal, provision or inspection of aircraft, airline facilities or maintenance facilities for aircraft;
- i) Arranging for the assessment of the aviation and aircraft market conditions;
- j) Marketing of leases that are operating leases;
- k) Providing finance in obtaining the ownership of an aircraft by an airline enterprise from another corporation that is a relevant qualifying aircraft lessor;
- l) Providing a residual value guarantee or contingent purchase arrangement;
- m) Providing services in relation to an aircraft leasing activity for or to another corporation that is a relevant qualifying aircraft lessor.

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