



Enhancing the Aircraft Leasing Preferential Tax Regime

Trade Consultation Paper

**Transport and Logistics Bureau
Inland Revenue Department**

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LIST OF ABBREVIATIONS

Abbreviation	Definition
ETR	Effective tax rate
CFC	Controlled Foreign Company
DIPN	Departmental Interpretation and Practice Notes
EU	European Union
GloBE	Global Anti-Base Erosion
IRR	Internal rate of return
In-scope MNE group	Multinational enterprise group with annual revenue equal to or exceeding €750 million
IRD	Inland Revenue Department
IRO	Inland Revenue Ordinance (Cap. 112)
Mainland	Mainland of China
MNE	Multinational enterprises
Net lease payments	Gross lease payments less deductible expenses (excluding depreciation allowance)
OECD	Organisation for Economic Co-operation and Development
Regime	Aircraft leasing preferential tax regime
STTR	Subject to Tax Rule

CHAPTER 1 INTRODUCTION

1.1 Civil aviation is a long-term growth business, with global and China's passenger traffic expected to grow at about 3.8% per annum and 4.9% per annum respectively over the next 20 years¹. At the same time, global air cargo is expected to grow at 4.1% per annum over the next 20 years¹. Boeing estimated that a total of over 41 100 aircraft will be delivered in the next 20 years, over 20% of which will be delivered to China. Financing this growth presents major business opportunities for the financial and other professional services.

1.2 The global aircraft leasing market has grown exponentially in the past few decades from 1% of the aircraft in use was leased in 1970 to 51% in 2021². There are a myriad of factors contributing to the attractiveness of aircraft leasing, such as financial flexibility, avoidance of large upfront investments, fleet flexibility, reduced delivery lead time for new planes, preservation of capital and capture of market share without significant capital commitment. As a successful international financial centre, Hong Kong already possesses favourable conditions necessary for developing aircraft leasing business, namely, our sound legal and banking systems, well-developed and diversified capital markets, excellent aviation infrastructure and talents, and proximity to the Mainland of China ("the Mainland") market. To capitalise on our strengths to develop aircraft leasing business, the Government introduced an aircraft leasing preferential tax regime ("Regime") in 2017 to provide global industry players with competitive profits tax concessions vis-à-vis those of other places.

1.3 In 2021, Hong Kong, together with more than 130 jurisdictions across the globe, pledged to implement the international tax reform proposals drawn up by the Organisation for Economic Co-operation and Development ("OECD") to address the challenges of base erosion and profit shifting ("BEPS") arising from the digitalisation of the economy (commonly known as BEPS 2.0). The BEPS 2.0 package consists of two pillars. In particular, Pillar Two introduces a global minimum effective tax rate ("ETR") set at 15%, which will apply to multinational enterprises ("MNE") with annual revenue equal to or exceeding €750 million ("in-scope MNE group")³. Top-up tax will be imposed in respect of a jurisdiction if the group's ETR in that jurisdiction is less than 15%. Owing to the prevailing design of the Regime, the implementation of BEPS 2.0 would render the Regime less competitive than that of other jurisdictions.

¹ Source: Commercial Market Outlook 2022-2041, World regions published by Boeing Capital in July 2022.

² Salas, Erick Burgueño. "Global Aviation Leasing Market Evolution 2021." Statista, April 12, 2022. <https://www.statista.com/statistics/1095749/share-leased-aircraft-aviation-industry-worldwide/>.

³ The ETR is to be computed on the basis of the group's income in Hong Kong computed under the Global Anti-Base Erosion ("GloBE") Rules and the covered taxes attributable to such income.

1.4 The Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area advocates leveraging on Hong Kong's strengths in financial and logistics services to develop high-value added aircraft leasing and aviation financing services. President Xi, in his important speech given in Hong Kong on 1 July 2022, also emphasised the need for Hong Kong to maintain our distinctive status and edges so as to improve its presence as an international financial, shipping and trading centre. The Government is determined to continue strengthening Hong Kong's competitiveness in the global aircraft leasing industry. It is therefore important to ensure that the Regime can keep up with market changes, which have been particularly rapid over the past few years.

1.5 Against this backdrop, the Government is planning to introduce enhancement measures to the Regime with a view to maintaining and enhancing its competitiveness. Stakeholders are invited to provide their views on the proposed enhancement measures covered in this paper. To ensure practicality and applicability, industry players are also invited to share experience and commercial practice to assist the Government in formulating the details of the enhancement measures.

CHAPTER 2 BACKGROUND

2.1 The Regime was introduced in 2017 by way of legislative amendments to the Inland Revenue Ordinance (Cap. 112) (“IRO”). The Regime consists of the following two key features –

- (a) the tax rate on the qualifying profits⁴ of qualifying aircraft lessors⁵ and qualifying aircraft leasing managers⁶ is 50% of the prevailing profits tax rate for corporations (i.e. 16.5% x 50% = 8.25%); and
- (b) as compensation for loss of depreciation allowances, the assessable profits derived from leasing of an aircraft to an aircraft operator by a qualifying aircraft lessor is equal to 20% of the net lease payments, i.e. gross lease payments less deductible expenses (excluding depreciation allowance).

Details of the Regime are reflected in the IRO and Inland Revenue Department’s (“IRD”) Departmental Interpretation and Practice Notes (“DIPN”) No. 54.

⁴ According to sections 14H and 14J of the IRO, “qualifying profits” means the assessable profits of a qualifying aircraft lessor derived from its qualifying aircraft leasing activity or the assessable profits of a qualifying aircraft leasing manager derived from its qualifying aircraft leasing management activity. It would also include income incidental to profits from an aircraft leasing business, like interest income, exchange gains or hedging gains, as long as the transactions are ancillary to the qualifying activities.

According to section 14G(6) of the IRO, an aircraft leasing activity carried out by a corporation (i.e. leasing an aircraft by the corporation to an aircraft operator) in respect of an aircraft is a qualifying aircraft leasing activity if (a) the activity is carried out in the ordinary course of the corporation’s business carried on in Hong Kong; and (b) the aircraft is owned by the corporation when the activity is carried out.

⁵ According to section 14H(2) of the IRO, a corporation is a *qualifying aircraft lessor* for a year of assessment if, in the basis period for that year of assessment –

- (a) it is not an aircraft operator;
- (b) it has carried out in Hong Kong one or more qualifying aircraft leasing activities; and
- (c) it has not carried out in Hong Kong any activity other than a qualifying aircraft leasing activity.

In other words, a qualifying aircraft lessor must be a standalone corporation engaging solely in qualifying aircraft leasing activities.

⁶ According to section 14J(2) of the IRO, a corporation is a *qualifying aircraft leasing manager* for a year of assessment if –

- (a) in the basis period for that year of assessment, it is not an aircraft operator; and
- (b) for that year of assessment –
 - (i) it is a dedicated aircraft leasing manager in section 14J(3) of the IRO that has satisfied the standalone corporation requirement;
 - (ii) it is an aircraft leasing manager that has satisfied the “1-year safe harbour” rule or the “multiple-year safe harbour” rule in section 14K of the IRO though it has carried out in Hong Kong activities other than a qualifying aircraft leasing management activity; or
 - (iii) it is an aircraft leasing manager that has been determined by the Commissioner of Inland Revenue under section 14L(1) of the IRO as a qualifying aircraft leasing manager though it satisfies neither of the conditions in (i) and (ii) above.

2.2 Since then, the aircraft leasing business has started to flourish in Hong Kong. A number of major industry players from the Mainland and overseas have set up their subsidiaries/operating arms in Hong Kong. We understand that aircraft lessors based or with subsidiaries set up in Hong Kong have leased around 95 aircraft to aircraft operators in the Mainland, Chile, Cambodia, Indonesia, Japan, South Korea, Malaysia, Qatar and Vietnam etc.

CHAPTER 3 PROPOSALS

A. Deduction of acquisition cost of aircraft

(i) *Tax deduction of acquisition cost of aircraft*

3.1 As aircraft leasing involves huge outlays in aircraft acquisition, tax treatment for acquisition cost of aircraft is important when an aircraft leasing company selects where to conduct its business.

3.2 Section 39E of the IRO is an anti-avoidance provision which aims at combating certain forms of leasing arrangements for abusing depreciation allowance in respect of machinery or plant (including aircraft). In the case of aircraft leasing, depreciation allowances would be denied in the case where a qualifying aircraft lessor leases an aircraft to a non-Hong Kong aircraft operator. Similar tax treatment also applies to sub-leases⁷. The objective of not amending section 39E when the Regime was introduced in 2017 was to safeguard its integrity.

3.3 Despite the reduced profit tax rate from 16.5% to 8.25% under the Regime, the lack of depreciation allowance would, however, render the ETR of the aircraft lessors conducting business via the Hong Kong platform much higher than that via other major platforms such as Ireland and Singapore. To address this, a 20% tax base concession was introduced to compensate for the lack of depreciation allowance under the Regime. This was based on the understanding that 20% of net lease payments generally represented the average profit margin of aircraft leasing business. Adopting a reduced tax base at 20% could render the internal rate of return (“IRR”) achieved from leasing to non-Hong Kong aircraft operators comparable with that from leasing to Hong Kong aircraft operators.

3.4 While the 20% tax base can help an aircraft lessor maintain its IRR whether leasing an aircraft to a Hong Kong aircraft operator or non-Hong Kong aircraft operator, unlike depreciation allowance, the lessor is not able to benefit from tax deferral⁸. Besides, under BEPS 2.0, the benefit conferred by the 20% tax base rule would be counteracted by the top-up tax liabilities with respect to low-taxed aircraft lessors under the GloBE Rules and/or the Subject to Tax Rule

⁷ If a qualifying aircraft lessor leases an aircraft by way of an operating lease to a Hong Kong aircraft operator which then sub-leases the aircraft to a non-Hong Kong aircraft operator due to operational reasons such as surplus capacity, section 39E of the IRO would be triggered to deny depreciation allowances.

⁸ Since an aircraft is a costly asset, granting depreciation allowance (effectively 72% of the cost of the aircraft for the year of acquisition) would lead to a significant amount of tax loss. Such loss will be carried forward to set off the assessable profits of the lessor for the subsequent years of assessment and in turn defer cash payment of tax for the aircraft lessor for a considerable period.

(“STTR”)⁹. If a Hong Kong aircraft lessor is a constituent entity of an in-scope MNE group, the tax concessions enjoyed by the lessor under the Regime may result in the group’s ETR in Hong Kong below the minimum rate of 15% and in turn top-up tax liabilities under the GloBE Rules. In determining the amount of covered taxes, deferred tax adjustments will be taken into account so as to address the temporary difference in the recognition of income and expense for accounting and tax purposes (e.g. difference between accounting depreciation and tax depreciation/deduction). Conversely, no adjustment on either the GloBE Income or covered taxes will be made to address most permanent differences in the accounting profits and tax base (e.g. exempted income or reduced tax base). It follows that a qualifying aircraft lessor under the Regime, though being able to benefit from the 20% tax base, would be liable to a greater amount of top-up tax under the GloBE Rules or domestic minimum top-up tax rules. Similarly, the lessor may also be subject to top-up tax under the STTR (minimum rate set at 9%) notwithstanding the reduced withholding tax rates provided under the comprehensive avoidance of double taxation agreements or arrangements between Hong Kong and other jurisdictions.

3.5 With the implementation of BEPS 2.0, the absence of depreciation allowance or tax deduction of the acquisition of aircraft leased to non-Hong Kong aircraft operators would put Hong Kong aircraft lessors in a relatively disadvantaged position when compared with aircraft lessors conducting business in other jurisdictions where capital allowance (including depreciation allowance for acquisition of aircraft) is generally allowable to aircraft lessors.

Proposal (1): To replace the 20% tax base concession with specific tax deduction of the acquisition cost of aircraft

Taking into account the calculation of ETR under BEPS 2.0, the Government **proposes** to amend the IRO to replace the 20% tax base concession for qualifying aircraft lessor with tax deduction consisting of the following features

—

- (a) A qualifying aircraft lessor should be allowed to deduct the full cost of an aircraft for the year of assessment in which the aircraft is acquired subject to a claw back mechanism detailed in part (b) below;
- (b) Deductions previously allowed would be clawed back upon the disposal of the aircraft and the sale proceeds (restricted to the deduction allowed) would be deemed as trading receipts; and

⁹ STTR is a treaty-based rule that allows source jurisdictions to impose limited source taxation on certain related party payments e.g. interest, royalties and a defined set of other payments subject to tax below the minimum rate of 9%.

- (c) Subject to proposal (2) below (if adopted), anti-avoidance provisions similar to those under section 14I(3) of the IRO would be introduced to deny the deduction for a year of assessment if the qualifying aircraft lessor or its connected person has been granted deduction or capital allowance in respect of the aircraft concerned for the same year of assessment.



Consultation questions for proposal (1)

- 1(a) Do you agree that replacing the 20% tax base concession with proposal (1) would make the Regime more attractive and competitive? Are there any tax and non-tax measures related to aircraft leasing imposed by other jurisdictions in response to the implementation of BEPS 2.0?
- 1(b) Do you agree that qualifying aircraft lessors should be allowed to deduct the full cost of the aircraft for the year of assessment in which the aircraft is acquired (i.e. one year) or should lessors be allowed to deduct the cost over a certain number of years? For the latter, how many years and why? Should a qualifying aircraft lessor be given a choice over the tax deduction period and why?
- 1(c) Do you agree that aircraft lessors would be more encouraged to conduct their businesses in Hong Kong with the introduction of proposal (1)? If so, how many additional aircraft do you think would be leased via the Hong Kong platform per year under this proposal? How many additional aircraft lessors do you anticipate would be interested in using Hong Kong as a platform to conduct aircraft leasing businesses?



(ii) *Application of anti-avoidance provisions*

3.6 Under the prevailing anti-avoidance provisions of the Regime (section 14I(3) of the IRO), the 20% tax base concession would not apply to a qualifying aircraft lessor for a year of assessment if, among others, capital allowance has been granted to a qualifying aircraft lessor or its connected person in respect of the aircraft concerned for the year of assessment. The purpose of such anti-avoidance provisions is to prevent a qualifying aircraft lessor and its connected person from obtaining double benefits with regard to the acquisition of the same aircraft. In other words, qualifying aircraft lessors should not be allowed to obtain both the capital allowance, whether in Hong Kong or in a territory outside Hong Kong, in respect of the capital expenditure on the provision of the same aircraft, and the 20% tax base concession under the Regime.

3.7 Since the introduction of the Regime, we have encountered cases concerning the following two scenarios where the trade considered that the 20% tax base concession should not be denied as no tax avoidance is involved –

- (a) the qualifying aircraft lessor is subject to extra-territorial taxation with capital allowance taken into account in a foreign jurisdiction e.g. through a controlled foreign company (“CFC”) regime; or
- (b) the aircraft is transferred from a foreign entity to the qualifying aircraft lessor and capital allowance has been claimed in a foreign jurisdiction with respect to the aircraft subject to a claw-back mechanism.

Proposal (2): To carve out scenarios mentioned in paragraphs 3.7 (a) and (b) from the anti-avoidance provisions regarding the eligibility of 20% tax base concession (or tax deduction in proposal (1) if adopted)

The Government **proposes** to amend the IRO to allow a qualifying aircraft lessor to enjoy the 20% tax base concession (or tax deduction in proposal (1) if adopted) under the following two scenarios –

- Where the lessor or its connected person is subject to extra-territorial taxation (e.g. through a CFC regime) in another jurisdiction whereby capital allowance has been taken into account. In such scenario, the CFC regime seeks to tax the income of the lessor and it is reasonable that a deduction of capital expenditure on the provision of the aircraft concerned should be allowed when computing the taxable profits. As the lessor’s income has been taxed both in Hong Kong and the jurisdiction of the parent company, the relevant anti-avoidance

provisions in section 14I(3) of the IRO, which aim to prevent possible abuses, should not apply.

- Where the capital allowances on an aircraft granted to the lessor's connected person in a jurisdiction outside Hong Kong have been fully clawed back in that jurisdiction through a mechanism similar to balancing charge under the IRO when the aircraft concerned is transferred to a Hong Kong aircraft lessor. Since the capital allowances have been fully clawed back, for the purposes of allowing the 20% tax base concession (or tax deduction in proposal (1) if adopted), it should be regarded as no capital allowance having been "granted" to the connected person in respect of the aircraft concerned for the year of transfer.



Consultation questions for proposal (2)

- 2(a) Do you agree that the anti-avoidance provisions should not apply under the scenarios mentioned in paragraphs 3.7 (a) and (b)? Are there any other scenarios in which you consider the anti-avoidance provisions should not apply while upholding the principle of preventing possible tax abuses? If so, please elaborate and provide reasons.
- 2(b) Do you agree that aircraft lessors would be more encouraged to conduct their businesses in Hong Kong with the introduction of proposal (2)? If so, how many additional aircraft do you think would be leased via the Hong Kong platform per year under this proposal? How many additional aircraft lessors do you anticipate would be interested in using Hong Kong as a platform to conduct aircraft leasing businesses?



B. Scope and coverage of lease and aircraft leasing activities

(i) Wet lease, funding lease and term of lease

3.8 Aircraft lessors may lease an aircraft via an operating lease (including dry lease or wet lease)¹⁰ or a finance lease (also known as “funding lease”)¹¹. According to section 14G (1) of the IRO, lease means a dry lease but does not include a dry lease that is a funding lease, hire-purchase agreement or conditional sale agreement. Hence, leasing of an aircraft via wet lease or funding lease is not eligible for tax concession under the Regime. Funding lease was specifically excluded from the Regime because at the time when the Regime was designed, the industry advised that setting up a special purpose vehicle with the only activity of holding an aircraft for dry lease was the most common form of structure for aircraft lessors.

3.9 According to section 14G (1) of the IRO, dry lease means an arrangement under which —

- (a) 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;
- (b) the lessor is not responsible for ensuring the airworthiness of the aircraft; and
- (c) no member of the crew of the aircraft is employed by the lessor.

3.10 According to section 14G (1) of the IRO, funding lease is defined as a dry lease of an aircraft —

- (a) that satisfies one of the following conditions at its inception —
 - (i) the dry lease is accounted for as a finance lease or loan by the lessor in accordance with —
 - (A) the Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants, as in force from time to time; or

¹⁰ A dry lease generally means a lease of the aircraft, not including crew, insurance and maintenance, whereas a wet lease is a typically short term lease for seasonal needs including the aircraft, crew, maintenance and insurance during the period of the lease.

¹¹ Funding lease is a financing arrangement under which the lessee is transferred the risks and rewards of the aircraft ownership and the aircraft lessor is the financier. The lessee is usually provided with an option to purchase the aircraft at the end of the leasing agreement.

- (B) the International Financial Reporting Standards issued by the International Accounting Standards Board, as in force from time to time;
 - (ii) the present value of the aggregate minimum lease payments (whether or not they are periodic payments and including any sum payable under a residual value guarantee) during the term of the dry lease is equal to or more than 80% of the fair market value of the aircraft;
 - (iii) the term of the dry lease is equal to or more than 65% of the remaining useful economic life of the aircraft; and
- (b) under which the property in the aircraft will or may pass to the lessee at the end of its term,

and includes an arrangement or agreement in connection with such a dry lease.

3.11 The Regime also contains a requirement that the lease term must exceed 1 year. This was included at the time of introducing the Regime based on the understanding that most of the lease arrangements should last for several years. Latest market information shows that leasing of aircraft via wet leases (i.e. operating leases with the provision of aircraft and crew) and funding leases is becoming more prevalent in recent years. It is also observed that the lease term could be less than 1 year, especially under the volatile market situation during the COVID-19 pandemic.

Proposal (3): To include wet lease and funding lease in the Regime and remove the restriction on term of lease

To cater for the latest development of the aircraft leasing industry, the Government **proposes** to amend the IRO to include wet lease and funding lease in the Regime. The proposed definition for an operating lease –

- (a) means,
 - (i) an arrangement under which a right to use an aircraft is granted by an owner of the aircraft to another person (specified head lease); or
 - (ii) an arrangement under which a right to use an aircraft is granted by a lessee under a specified head lease (or by a sub-lessee or

any other person deriving the right under the lessee) to another person; and

(b) does not include a funding lease.

For funding lease, it is proposed to continue using the prevailing definition set out in paragraph 3.10 above (section 14G (1) of the IRO).

The Government also **proposes** to amend the IRO to remove the one-year restriction on the term of dry lease. There should not be restriction on the term of lease.



Consultation questions for proposal (3)

- 3(a) Do you agree that wet lease and funding lease should be included in the Regime? Do you know the respective proportion of aircraft leasing deals/leasing agreements conducted under dry lease, wet lease and funding lease in the global and/or Asian market?
- 3(b) Do you agree that the proposed definition of operating lease is appropriate and sufficient to capture operating lease for aircraft leasing? If not, what other features of operating lease should be incorporated into the definition?
- 3(c) Do you agree that the prevailing definition of funding lease under the Regime (paragraph 3.10) is sufficient to capture funding lease for aircraft leasing? If not, what other common features of funding lease should be incorporated into the definition?
- 3(d) Do you agree that the 20% tax base concession (or tax deduction in proposal (1) if adopted) should be granted to qualifying aircraft lessors for operating lease (including dry and wet leases) but not funding lease because under a funding lease arrangement, it should be the lessee rather than the lessor to be eligible for tax depreciation?
- 3(e) Do you agree that there should be no restriction on the term of lease? How long is the usual term of dry lease, wet lease and funding lease respectively?

3(f) Do you agree that aircraft lessors would be more encouraged to conduct their businesses in Hong Kong with the introduction of proposal (3)? If so, how many additional aircraft do you think would be leased via the Hong Kong platform per year under this proposal? How many additional aircraft lessors do you anticipate would be interested in using Hong Kong as a platform to conduct aircraft leasing businesses?



(ii) *Scope of aircraft leasing activities*

3.12 Currently, the scope of aircraft leasing activity under the Regime is confined to leasing of an aircraft to an aircraft operator (section 1 of Schedule 17F of the IRO). An aircraft operator is defined as a person carrying on an aircraft operation business, which is a business of operating aircraft as an owner or a charterer for providing services for the carriage by air of passengers, cargo or mail, but does not include dealing in aircraft or agency business in connection with air transport. While leasing of an aircraft to an aircraft operator remains the major business of aircraft lessors, other types of aircraft leasing activities have been developed especially during the COVID-19 pandemic when the demand for air travel was low. We understand that aircraft lessors now lease aircraft to other entities including private companies, public organisations or even individuals. The scope of definition of aircraft leasing activity should be expanded to keep up with the industry’s development.

Proposal (4): To expand the definition of aircraft leasing activity

To allow flexibility for different types of leasing activities in the future, the Government **proposes** to amend the IRO to provide for a more general meaning of “aircraft leasing activity”, i.e. leasing an aircraft by an aircraft lessor irrespective of whether the aircraft is leased to an aircraft operator or non-aircraft operator.



Consultation questions for proposal (4)

- 4(a) Do you agree that expanding the definition of aircraft leasing activity would make the Regime more attractive?
- 4(b) Do you agree that a general approach should be adopted when amending the definition of aircraft leasing activity? Or should a targeted approach, i.e. only covering specified types of non-aircraft operator lessees, be adopted?
- 4(c) Do you agree that aircraft lessors would be more encouraged to conduct their businesses in Hong Kong with the introduction of proposal (4)? If so, how many additional aircraft do you think would be leased via the Hong Kong platform per year under this proposal? How many additional aircraft lessors do you anticipate would be interested in using Hong Kong as a platform to conduct aircraft leasing businesses?



C. Interest deduction

(i) *Deduction of interest payable to a financier outside Hong Kong who is not a financial institution and may be an associate of the borrower*

3.13 Interest expenses incurred in the production of chargeable profits are allowed for deduction under section 16(1)(a) of the IRO subject to, among others, the satisfaction of any condition stipulated in sections 16(2)(a) to (g) of the IRO. Insofar as it is relevant, interest incurred by an aircraft lessor is allowable for deduction if –

- (a) the money is borrowed from a lender whose interest income is chargeable to profits tax under the IRO or a financial institution; or
- (b) the money borrowed is wholly or exclusively used for financing the acquisition of machinery and plant and the lender is not an associate of the borrower.

3.14 Some qualifying aircraft lessors have expressed concerns on the non-deductibility of their interest payable on the money borrowed for financing the acquisition of aircraft as the lender is a financier outside Hong Kong that is an associate and is not a financial institution.

Proposal (5): To allow deduction of interest payable to a financier outside Hong Kong who is not a financial institution and may be an associate of the borrower subject to certain conditions

To accommodate the different financing means for the acquisition of aircraft, the Government **proposes** to amend the condition of interest deduction under section 16(2) of the IRO so that interest payable on money borrowed from a non-associated financier outside Hong Kong (whether or not it is a financial institution) that is wholly and exclusively to finance the acquisition of an aircraft used by a qualifying aircraft lessor for producing its qualifying profits is deductible. If the financier outside Hong Kong is an associate of the borrower, the interest deduction will be subject to certain anti-abuse provisions (e.g. subject to tax condition) so as to forestall aggressive tax avoidance schemes creating interest expenses to reduce assessable profits in Hong Kong.



Consultation questions for proposal (5)

- 5(a) Do you agree that the interest payable on money borrowed wholly and exclusively to finance the acquisition of an aircraft used by a qualifying aircraft lessor for producing its qualifying profits should be deductible (subject to certain anti-avoidance provisions)? What are the common means of financing the acquisition of an aircraft other than borrowing from a financial institution?
- 5(b) Do you agree that aircraft lessors would be more encouraged to conduct their businesses in Hong Kong with the introduction of proposal (5)? If so, how many additional aircraft do you think would be leased via the Hong Kong platform per year under this proposal? How many additional aircraft lessors do you anticipate would be interested in using Hong Kong as a platform to conduct aircraft leasing businesses?



(ii) *Recognised stock exchange*

3.15 Under section 16(2)(f)(i) of the IRO, interest can be allowed for deduction if it is payable on debentures listed on a stock exchange in Hong Kong or on any other stock exchange recognised by the Commissioner of Inland Revenue. At present, the Irish Stock Exchange is not on the list. We understand that many aircraft leasing groups raise bond financing or have notes in asset backed securitisation structures which are listed in Ireland.

Proposal (6): To allow the deduction of interest payable on bonds and notes listed on the Irish Stock Exchange

Noting that Ireland is a member of the European Union (“EU”) and hence subject to the rules and regulations of the EU, the Government **proposes** to recognise the Irish Stock Exchange under section 16(2)(f)(i) of the IRO in order to facilitate the financing of aircraft leasing companies.



Consultation questions for proposal (6)

- 6(a) Do you agree that the Government should recognise the Irish Stock Exchange for the purpose of interest deduction under section 16(2)(f)(i) of the IRO? Are there other stock exchanges commonly used by aircraft leasing companies to raise funds for acquiring aircraft?
- 6(b) Do you agree that aircraft lessors would be more encouraged to conduct their businesses in Hong Kong with the introduction of proposal (6)? If so, how many additional aircraft do you think would be leased via the Hong Kong platform per year under this proposal? How many additional aircraft lessors do you anticipate would be interested in using Hong Kong as a platform to conduct aircraft leasing businesses?



D. Threshold requirement

3.16 In determining whether a preferential tax regime meets the international standards on anti-base erosion and profit shifting, OECD will take into account whether the regime can meet the substantial activities requirements. Specifically, OECD expects that a qualifying taxpayer should, in the jurisdiction that offers the tax concessions –

- (a) employ an adequate number of full-time qualified employees; and
- (b) incur an adequate amount of operating expenditure.

No threshold requirement for aircraft lessor and aircraft leasing manager is now prescribed in law.

Proposal (7): To prescribe the threshold requirement to comply with OECD’s criteria

To meet the requirements of OECD, the Government **proposes** to amend the IRO to prescribe the threshold requirements for aircraft lessor and aircraft leasing manager as follows –

	Full-time employees	Operating expenditure
Aircraft lessors	1	HK\$ 2 million
Aircraft leasing manager	2	HK\$ 10 million



Consultation questions for proposal (7)

- 7(a) How many full-time employees are employed under your aircraft leasing company and/or aircraft leasing management company?
- 7(b) What is the approximate annual operating expenditure of your aircraft leasing company and/or aircraft leasing management company?
- 7(c) Do you agree that the proposed threshold level included in proposal (7) appropriate and would ensure the attractiveness and competitiveness of the Regime?



E. Leasing model involving bare trust

3.17 To be eligible for tax concession under the Regime, section 14H(2) of the IRO requires that a qualifying aircraft lessor must, *inter alia*, carry out in Hong Kong one or more qualifying aircraft leasing activities. Such aircraft leasing activities must be carried out in the ordinary course of its business in Hong Kong and the aircraft concerned must be owned by the lessor. For the purposes of the Regime, the word “own” covers not only legal ownership, but also economic/beneficial ownership. We understand that there has been an increase in the use of bare trustee which holds the legal ownership of an aircraft while the lessor acts as the beneficial owner of the aircraft. This leasing model is becoming increasingly popular as it facilitates the trade of the leased aircraft by transfer of beneficial ownership, without the necessity to novate the underlying lease.

3.18 An example of leasing model involving bare trust is appended below.

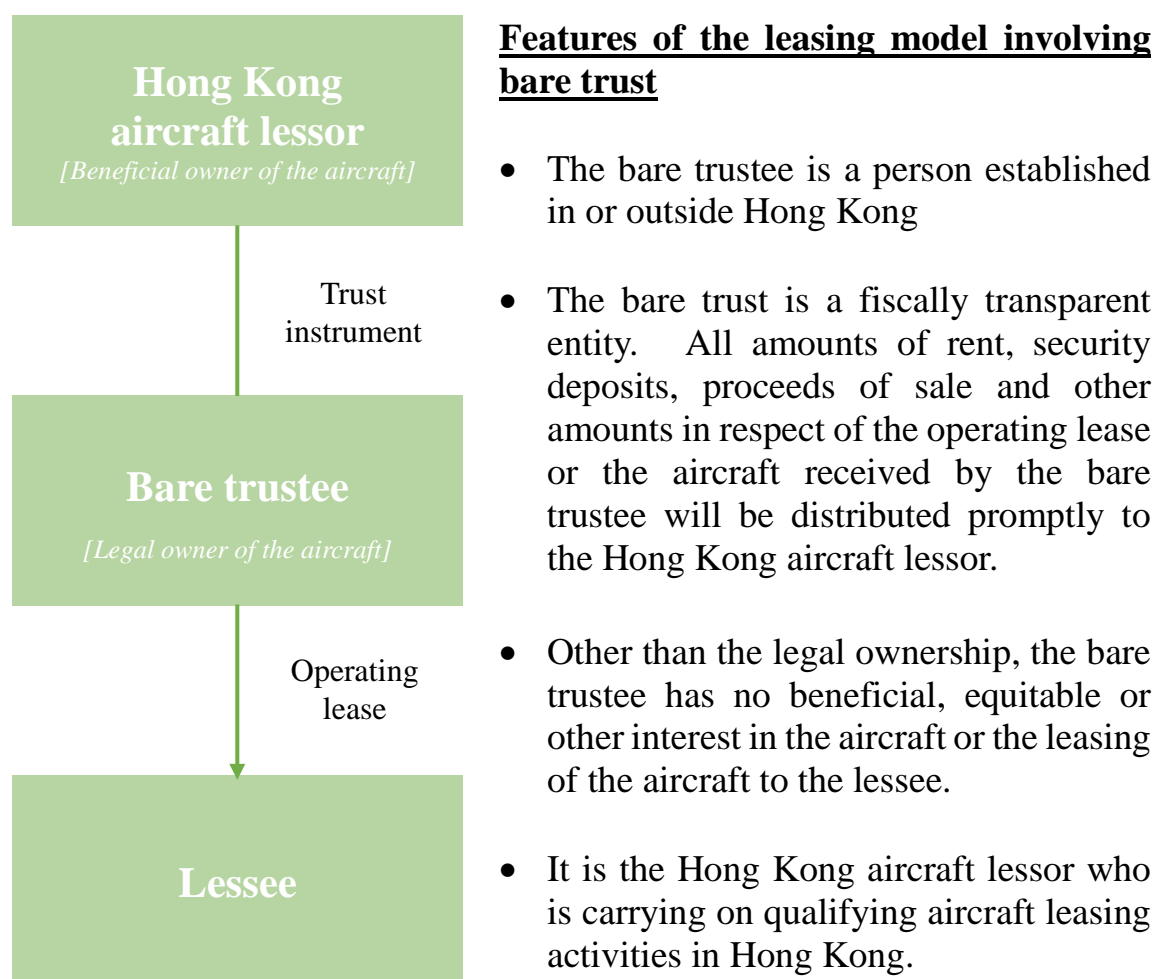


Figure 1: leasing model involving a bare trustee.

Proposal (8): To specify that a qualifying aircraft lessor can benefit from the tax concession under a leasing model involving the use of a bare trust

The Government **proposes** to update IRD's DIPN No. 54 to provide guidance to the trade for leasing model involving a bare trust. Provided that other conditions of the Regime are satisfied and the trustee is merely the registered owner of the aircraft, a qualifying aircraft lessor, being the beneficial owner of the aircraft, will be entitled to the tax concession notwithstanding that the aircraft is held by a trustee in trust for the lessor.



Consultation questions for proposal (8)

- 8(a) Do you agree that specifying the leasing model involving bare trust in the DIPN No. 54 could provide clarity and guidance for the trade? What are the common leasing model structures involving the use of a bare trust? Are there other new leasing models gaining popularity in the trade?
- 8(b) Do you agree that aircraft lessors would be more encouraged to conduct their businesses in Hong Kong with the introduction of proposal (8)? If so, how many additional aircraft do you think would be leased via the Hong Kong platform per year under this proposal? How many additional aircraft lessors do you anticipate would be interested in using Hong Kong as a platform to conduct aircraft leasing businesses?



CHAPTER 4 INVITATION OF VIEWS

4.1 Your comments and suggestions on the proposals for enhancing the Regime are much needed. We will consolidate and analyse the views received in this consultation before drawing up a more detailed proposal to be materialised through both administrative and legislative means.

4.2 Please provide your written submission on the proposals and consultation questions on or before 19 December 2022 through one of the channels below –

Address: Transport and Logistics Bureau
21/F, East Wing, Central Government Offices
2 Tim Mei Avenue, Tamar
Hong Kong
(Attn: Assistant Secretary for Transport and Logistics 8A)
(Re: Enhancing the Aircraft Leasing Preferential Tax Regime)

Fax: 2524 9397

Email: aircraftleasing2022@tlb.gov.hk

4.3 We will treat all submissions received as public information, which may be reproduced and published in any form for the purposes of this consultation exercise and any directly related purposes without seeking permission of or providing acknowledgement to the respondents. We may, either in public or private discussions, or in any subsequent report, cite comments submitted in response to this consultation paper.

4.4 It is optional for individuals and/or organisations to supply their personal data when providing views on this consultation paper. The submissions and personal data collected may be transferred to the relevant Government bureaux and departments for purposes directly related to this consultation exercise. The Government bureaux and departments receiving the data may only use the data for such purposes. The names and background information of the respondents may be posted on the website of the Transport and Logistics Bureau, referred to in other documents published for the same purposes, or transferred to other relevant bodies for the same purposes. If you do not wish your name and/or your background information to be disclosed, please state so when making your submission. Any part of the submissions considered commercially confidential should be clearly marked. The Transport and Logistics Bureau and/or IRD would take such markings into account in making the decision as to

whether or not to disclose such information.

4.5 Thank you for taking part in this consultation exercise.

**Transport and Logistics Bureau
Inland Revenue Department
November 2022**