Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By email (bc_104_16@legco.gov.hk) and by hand

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Your Ref.: CB4/BC/4/16
Our Ref.: C/TF, M111032

Hon. Kenneth Leung
Chairman,
Bills Committee on Inland Revenue (Amendment) (No.2) Bill 2017,
Legislative Council Complex,
1 Legislative Council Road,
Central, Hong Kong

Dear Mr. Leung,

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

Thank you for inviting the views of the Hong Kong Institute of Certified Public Accountants ("the Institute") on the Inland Revenue (Amendment) (No.2) Bill 2017. The Institute's Taxation Faculty has considered the bill.

We are in support of encouraging the development of the aircraft financing business in Hong Kong, given the global trend of increasing aircraft fleet sizes and the importance of strengthening Hong Kong's competitive edge as a finance centre, as outlined in the Legislative Council Brief.

While we support the principle, we do have some concerns about the detailed drafting of the bill. These are explained below.

1. The tax concession for qualifying aircraft lessors applies to qualifying aircraft leasing activities, which qualify only if aircraft are leased to a non-Hong Kong aircraft operator. A non-Hong Kong aircraft operator is defined as an aircraft operator which is not chargeable to Hong Kong profits tax. However, section 23D of the Inland Revenue Ordinance (Cap. 112) deems non-Hong Kong resident aircraft operators (and owners) to be carrying on business in Hong Kong, and therefore chargeable to profits tax, where any aircraft operated (or owned) by that person lands at any airport within Hong Kong. Therefore, no aircraft lessor will be able to qualify for the tax concession if it leases aircraft to an airline flying any routes that land in or take off from Hong Kong. This would seem to exclude, for example, many Mainland operators, even though the Legislative Council Brief highlights the Mainland as an important target market. While under the terms of Hong Kong's double tax agreements ("DTAs"), in practice, non-resident operators may not be taxable in Hong Kong, the question of whether a person is chargeable to tax in Hong Kong should look first to the domestic legislation rather than to DTAs, which do not provide for chargeability as such, but instead allocate taxing rights between jurisdictions.

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In any event, it is possible that such airlines may have other activities in Hong Kong, such as ground handling or ticketing, for which they earn fee income that would not qualify for exemption under a DTA. As the mischief that this provision seems to be aimed at is to ensure that no Hong Kong deduction is able to be claimed for the lease payments paid to qualifying aircraft lessors, a better approach may be to clarify through the definitions that a non-Hong Kong aircraft operator is an aircraft operator which is not actually subject to profits tax on relevant carriage shipped in Hong Kong.

In addition, under the bill, in order to qualify for the aircraft leasing manager tax concession, a company may provide aircraft leasing management activities only to a qualifying aircraft lessor, so, for the similar reasons, the scope of that concession will also be severely curtailed.

The above restrictions, whether intended or not, would seem to dilute the benefits of the proposed tax concessions aimed at promoting Hong Kong as a regional centre for the aircraft financing business.

2. The tax concession for qualifying aircraft leasing managers applies only where the aircraft leasing manager activities are provided to a qualifying aircraft lessor. In some circumstances, this requirement will prove difficult, if not, impossible to satisfy. For example, based on our interpretation of the relevant provision, which is not entirely clear, in the proposed new Schedule 17, section 1(k), "providing finance in obtaining the ownership of an aircraft by an airline enterprise from another corporation that is a relevant qualifying aircraft lessor," the activity of providing finance to an airline enterprise cannot be provided to a qualifying aircraft lessor, as an aircraft operator is specifically precluded from being a qualifying aircraft lessor.

3. The anti-avoidance provision requiring the aircraft leasing manager to be centrally managed and controlled in Hong Kong to qualify for the tax concession would appear to discriminate against non-resident companies operating in Hong Kong. Therefore, it may be inconsistent with the non-discrimination articles in Hong Kong's comprehensive DTAs with other jurisdictions.

4. The requirement that, in many cases, the lease, or any arrangement or agreement in connection with it, cannot provide that the ownership of the aircraft will or may pass to the lessee at the end of the lease seems unduly restrictive. While it would seem to be possible to request a ruling from the Commissioner that this will not apply in a particular case, pursuant to the proposed new section 14G(5), on the basis that the Commissioner considers it unlikely that ownership will pass to the lessee, this creates an additional administrative burden on the taxpayer and uncertainty in the application of the provisions.

In addition, is the stipulation that a dry lease does not include a funding lease necessary at all? A funding lease is defined to include leases that have the features of a finance lease and under which ownership will or may pass at the end of the lease. Given that the existing definition of a hire purchase agreement already covers leases under which ownership will or may pass, and such agreements are already excluded from the definition of a lease in the proposed section 14G, the aforementioned requirement seems to impose an unnecessary further restriction.

Should you have any questions on our submission, please contact me on 2287 7084 or by email at peter@hkicpa.org.hk

Yours sincerely,

Peter Tisman
Director, Advocacy & Practice Development

PMT/EC/sc