

# Aircraft Leasing



## An Overview of the Concessionary Tax Regime for Aircraft Leasing in Hong Kong

### a) Concession for qualifying aircraft lessor

Under the concessionary tax regime, a qualifying aircraft lessor is entitled to have its qualifying profits charged at one-half of the corporate profits tax rate i.e. 8.25%. Qualifying profits would 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.

As a compensation for loss of depreciation allowances, a qualifying aircraft lessor is eligible for a 20% tax base concession. Generally speaking, the corporate profits tax liability of a qualifying aircraft lessor is computed as follows:-

$$\text{Corporate profits tax liability} = [\text{gross lease rentals} - \text{deductible expenses (excluding tax depreciation allowances on the aircraft concerned)}] \times 20\% \times 8.25\%$$

Gains derived by a qualifying aircraft lessor from the disposal of an aircraft are regarded as capital gains and not subject to Hong Kong profits tax if the lessor has used the aircraft for carrying out a qualifying aircraft leasing activity for a continuous period of at least 3 years immediately prior to its disposal. However, in practice any gains arising on the disposal of aircraft should not be subject to any tax in Hong Kong provided that they are capital in nature.

### b) Concession for qualifying aircraft leasing manager

A qualifying aircraft leasing manager is entitled to have its qualifying profits charged at one-half of the corporate profits tax rate i.e. 8.25%. The qualifying profits would include income incidental to profits from an aircraft leasing management business, like interest income, exchange gains, or hedging gains, as long as the transactions are ancillary to the qualifying activities.

It should be noted that safe harbour rule may apply which seeks to allow companies having profits and assets primarily for qualifying aircraft leasing management activities to be entitled to the half rate concession in respect of the qualifying profits.

### Half rate concession

The half rate concession applies to a qualifying aircraft lessor or a qualifying aircraft leasing manager for a year of assessment only if-

a) in that year of assessment-

- (i) the central management and control of the qualifying aircraft lessor or the qualifying aircraft leasing manager is exercised in Hong Kong (*the central management and control requirement*);
- (ii) the activities that produce its qualifying profits in that year are carried out in Hong Kong or arranged to be carried out in Hong Kong (*the substantial activity requirement*); and
- (iii) those activities are not carried out by a permanent establishment outside Hong Kong (*the attribution to Hong Kong requirement*); and

b) the qualifying aircraft lessor or the qualifying aircraft leasing manager has made an election in writing, which is irrevocable, that the half rate concession applies to it.

### 20% tax base concession

The 20% tax base concession would not apply to a qualifying aircraft lessor for a year of assessment in the following circumstances-

- a) the qualifying aircraft lessor has not incurred capital expenditure on the provision of the aircraft concerned.
- b) depreciation allowances have been granted to the qualifying aircraft lessor or its connected person in respect of the capital expenditure incurred on the provision of the aircraft concerned in Hong Kong.
- c) capital allowances are granted to a connected person of the qualifying aircraft lessor, whether in Hong Kong or in a territory outside Hong Kong, for that year of assessment in respect of the capital expenditure on the provision of the aircraft concerned.



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## Substantial Business Presence

Hong Kong's tax treaty partners have expressed their views that a company without business substance should not be entitled to any tax treaty benefits. The Final Report of BEPS Action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) has identified tax treaty abuses, and in particular treaty shopping, as one of the most critical concerns of BEPS. Hong Kong is committed to implementing the minimum standard on Action 6, which entails the inclusion in Hong Kong's tax treaties an express statement that the common intention of the contracting parties is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, and the implementation of this common intent through, amongst others, the principle purposes test.

Though there is no restriction on the place of incorporation, qualifying aircraft lessors and qualifying aircraft leasing managers need to ensure that they have a substantial business presence in Hong Kong. Any artificial arrangement to transfer existing leasing arrangements from other jurisdictions to Hong Kong for the purpose of obtaining unintended tax treaty benefits may not be accepted by tax treaty partners.

### a) Central management and control ("CMC")

Generally speaking, the central management and control is located in Hong Kong if the executive officers and senior management employees of the qualifying aircraft lessor and qualifying aircraft leasing manager exercise day-to-day responsibility for more of their strategic, financial and operational policy decision-making in Hong Kong and conduct more of the day-to-day activities necessary for preparing and making those decisions in Hong Kong, than in any other jurisdiction. The location of CMC is wholly a question of fact and must be decided on its own facts.

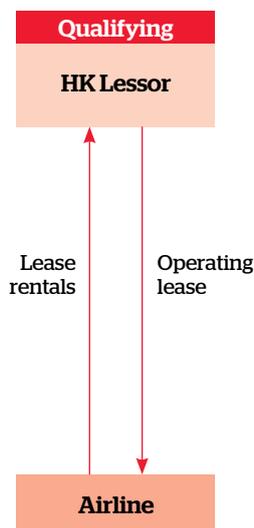
### b) Substantial activity

The substantial activity requirement ensures that the aircraft leasing functions or the aircraft leasing management functions are performed in Hong Kong, the assets including the aircraft concerned are acquired or monitored in/from Hong Kong and the risks associated with the aircraft leasing business or the aircraft leasing management business are undertaken in Hong Kong. The core income generating activities need to be carried out in Hong Kong. Such activities include raising funds, agreeing funding terms; identifying and acquiring aircraft to be leased, soliciting lessees; setting the terms and duration of leases; monitoring and revising lease agreements; managing any risks and maintaining documentation.

Taking note that different companies may have different business models, all the relevant facts and circumstances should be considered when determining whether the CMC and substantial activity requirements are satisfied. To secure tax certainty, a request in respect of a specific transaction or structuring may be made to the Commissioner for a ruling on how the provisions of aircraft leasing regime are to apply to the applicant.

## HK Lessor to Aircraft Operator

 Lease arrangement	<ul style="list-style-type: none"><li>• Operating lease to an airline</li><li>• Not funding lease, conditional sale or hire purchase</li></ul>
 Ownership	<ul style="list-style-type: none"><li>• HK Lessor has economic ownership</li></ul>
 Sub-leasing	<ul style="list-style-type: none"><li>• Not applicable</li></ul>
 Double dip	<ul style="list-style-type: none"><li>• No double dip</li></ul>
 Central management and control	<ul style="list-style-type: none"><li>• In HK</li></ul>
 Concessionary tax rate	<ul style="list-style-type: none"><li>✓Qualifying aircraft lessor ✓Qualifying aircraft leasing activity</li><li>• HK Lessor can elect into the new tax regime</li><li>• Concessionary tax rate available for HK Lessor</li></ul>



Departmental Interpretation and Practice Notes No.54 (Taxation of Aircraft Leasing Activities)



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