HONG KONG TAX ALERT

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KPMG welcomes the passing of the aircraft leasing tax incentive

Summary

The concessionary tax regime for certain aircraft leasing activities was enacted on 28 June 2017. This legislation will enable Hong Kong to take its place on the world stage as one of the premier locations for basing aircraft leasing activities.

There are practical details that will need to be resolved as lessors look to apply the law in practice. The IRD has indicated that it will likely issue a Departmental Interpretation and Practice Note to clarify some of these issues.

Background

The concessionary tax regime for certain aircraft leasing activities was enacted on 28 June 2017. The new rules will apply from the 2017/18 year of assessment.

To recap, the main benefits of the proposed regime are two-fold:-

- Aircraft leasing income earned by "qualifying aircraft lessors" will be taxed at 1.65% of rental receipts. (This is achieved by applying a tax rate of 8.25% - i.e. one half of the normal Hong Kong Profits Tax rate - to 20% of the gross rental receipts less deductible expenses such as funding costs, but excluding tax depreciation.)

- The same 8.25% tax rate will apply to "qualifying aircraft leasing management activities". This is widely defined to include, in addition to the standard lease management activities of procuring and leasing aircraft, a range of financing activities such as providing loans to associated companies to acquire the aircraft, providing loans to airlines to acquire the aircraft from qualifying lessors and providing residual value guarantees.

This legislation is a welcome development because it will enable Hong Kong to take its place on the world stage as one of the premier locations for basing aircraft leasing activities. In particular, Hong Kong's advantages of its proximity to the PRC and its "best in class" tax treaty with the PRC make it a natural place for offshore leasing of aircraft to PRC airlines.

What happens next?

As with any new law, there are certain details that will need to be resolved as lessors look to apply the law in practice. The Hong Kong Inland Revenue Department (IRD) has indicated that it will provide guidance on the application of the new regime through a Departmental Interpretation and Practice Note.

Hopefully, this note will be issued shortly and will address some practical issues.

What are the issues that need to be clarified?

- A common feature of an aircraft leasing business is to sell the aircraft as part of refreshing and recapitalising the lessor's fleet. The new law provides a 3-year safe harbour with respect to the taxability of gains arising from such sales, but some clarity is needed about the gains to be derived from aircraft that are sold within 3 years.

- For various commercial, funding and regulatory reasons, aircraft leasing structures tend to be more complex than having a Hong Kong SPV simply purchase an aircraft and lease it directly to an airline. A pragmatic approach from the IRD to applying the regime in the real world will be important to making it work in practice.

- Leases are cross border in nature and rely heavily on tax treaty benefits. The issue of tax residency certificates to lessors on a timely basis will be vitally important in securing tax treaty benefits, such as reduced withholding taxes. Recent experience is that the IRD has made it increasingly difficult to obtain these certificates for SPVs that do not have substantial business operations. The IRD has indicated that it will take account of "whether the SPVs have substantial connections with a qualifying aircraft leasing manager in Hong Kong." Hopefully, the DIPN will make this clear and enable companies to obtain certificates on a timely basis.

- For international leasing companies, it is likely that they will retain multiple leasing platforms in places such as Hong Kong, Ireland and elsewhere. This will naturally lead to the centralisation of certain management functions, potentially outside Hong Kong. Because lessors and managers must be residents in Hong Kong to qualify for the new tax concessions, how much of their management functions need to be in Hong Kong would be an issue.

Comment

Overall, the new tax regime represents another step in the Government's efforts to promote Hong Kong as a leading global financial centre. KPMG welcomes these efforts. Hopefully, we will continue to see more reforms of Hong Kong's tax laws to make Hong Kong increasingly attractive for establishing new businesses.

Contact us:

Lewis Y. Lu
Head of Tax, KPMG China
Tel: +86 21 2212 3421
lewis.lu@kpmg.com

Curtis Ng
Head of Tax, Hong Kong
Tel: +852 2143 8709
curtis.ng@kpmg.com

Corporate Tax

Chris Abbiss
Head of Real Estate Tax, KPMG China
Tel: +852 2826 7226
chris.abbiss@kpmg.com

Stanley Ho
Principal
Tel: +852 2826 7296
stanley.ho@kpmg.com

Charles Kinsley
Principal
Tel: +852 2826 8070
charles.kinsley@kpmg.com

Alice Leung
Partner
Tel: +852 2143 8711
alice.leung@kpmg.com

John Timpany
Partner
Tel: +852 2143 8790
john.timpany@kpmg.com

Matthew Fenwick
Director
Tel: +852 2143 8761
matthew.fenwick@kpmg.com

Sandy Fung
Director
Tel: +852 2143 8821
sandy.fung@kpmg.com

Ivor Morris
Director
Tel: +852 2847 5092
ivor.morris@kpmg.com

Natalie To
Director
Tel: +852 2143 8509
natalie.to@kpmg.com

Michael Olesnicky
Special Advisor
Tel: +852 2913 2980
michael.olesnicky@kpmg.com

M & A Tax

Darren Bowdern
Head of Financial Services Tax, KPMG China
Tel: +852 2826 7166
darren.bowdern@kpmg.com

Yvette Chan
Principal
Tel: +852 2847 5108
yvette.chan@kpmg.com

Benjamin Pong
Principal
Tel: +852 2143 8525
benjamin.pong@kpmg.com

Malcolm Prebble
Principal
Tel: +852 2685 7472
malcolm.j.prebble@kpmg.com

China Tax

Karmen Yeung
Partner
Tel: +852 2143 8753
karmen.yeung@kpmg.com

Daniel Hui
Principal
Tel: +852 2685 7815
daniel.hui@kpmg.com

Adam Zhong
Principal
Tel: +852 2685 7559
adam.zhong@kpmg.com

Travis Lee
Director
Tel: +852 2143 8524
travis.lee@kpmg.com

Steve Man
Director
Tel: +852 2978 8976
steve.man@kpmg.com

Transfer Pricing

John Kondos
Seconded Partner
Tel: +852 2685 7457
john.kondos@kpmg.com

Lu Chen
Principal
Tel: +852 2143 8777
lu.l.chen@kpmg.com

Irene Lee
Director
Tel: +852 2685 7372
irene.lee@kpmg.com

Global Mobility Services

Barbara Forrest
Principal
Tel: +852 2978 8941
barbara.forrest@kpmg.com

Murray Sarelius
Principal
Tel: +852 3927 5671
murray.sarelius@kpmg.com

David Siew
Principal
Tel: +852 2143 8785
david.siew@kpmg.com

Erica Chan
Director
Tel: +852 3927 5572
erica.chan@kpmg.com

Kate Lai
Director
Tel: +852 2978 8942
kate.lai@kpmg.com

US Tax

Wade Wagatsuma
Head of US Corporate Tax, KPMG China
Tel: +852 2685 7806
wade.wagatsuma@kpmg.com

Becky Wong
Director
Tel: +852 2978 8271
becky.wong@kpmg.com

Indirect Tax

Lachlan Wolfers
Head of Indirect Tax, KPMG China Regional Leader, Asia Pacific Indirect Tax
Tel: +852 2685 7791
lachlan.wolfers@kpmg.com

kpmg.com/cn