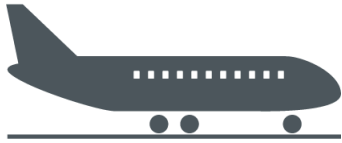




## **Asia's Financial Skies**

Understanding the impact of Hong Kong's new tax regime for the aircraft leasing industry



- Scenario
  - Senior Director of an international Venture Capital company
  - Charged with managing funds in excess of US500mm
  - High Growth in Aviation Leasing (particularly in Asia) – attractive returns
  - Board mandates you to take charge and develop an Aircraft leasing platform

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First Question:  
Where will you set up your Business?



- 
- RELEVANT CONSIDERATIONS:
  - Ability to move money and profits
  - Ease of raising finance for Asset Acquisitions
  - Stable legal & regulatory environment
  - Proximity to market players
  - Ease of aircraft asset trading/ownership risks
  - Accessing global talent pool
  - Stable living and labour Environment
  
  - LOW TAX JURISDICTION



# Agenda

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- Introduction
- Understanding the Proposed Legislative Changes
- Practical Legal Considerations



# The Inland Revenue (Amendment)(No.2) Bill 2017 (“Bill”)

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- HK government releases “The Inland Revenue (Amendment)(No.2) Bill 2017”
- proposes a new “standalone” tax regime specific for Hong Kong’s aircraft financing and leasing industry
- aimed to improve the competitiveness of Hong Kong for offshore aircraft leasing activities

# 3 Key Incentives

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## **A. Reduced Corporate Tax Rate**

Applies to: Qualifying Aircraft Lessors &  
Qualifying Aircraft Leasing Managers

(50% Profits Tax Concession)

## **B. Deemed reduced tax base of lease payments**

Applies to: Qualifying Aircraft Lessors only  
(20% Deemed Tax Base Concession)

## **C. Aircraft as Capital Assets Disposal Gains Not Taxable**

Applies to: Qualifying Aircraft Lessors only

Tax Concessions arising from A and B (above) effectively reduces profits tax rate for qualifying aircraft lessors to 1.65%

## A. 50% Profits Tax Concession

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The tax rate on the **qualifying profits** of:

- 1. qualifying aircraft lessors** and
- 2. qualifying aircraft leasing managers**

will be **50%** of the prevailing profits tax rate for corporations

(being the current Corporate Tax rate (16.5%)) x 50% = 8.25%

Note – Applies to both Qualifying Aircraft Lessors and Managers



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**What qualifies**  
**as a**  
**“qualifying aircraft lessor”**  
**and**  
**“qualifying aircraft lease manager”**

# Qualifying Aircraft Lessor

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Qualifying Aircraft Lessor: a Corporation that:

- Is a not an aircraft operator
- solely carries out “qualified aircraft leasing activities” in HK
- Activities that produce qualifying profits are carried out in HK (or arranged by QAL to be carried out in HK)
- Central Management and Control - common law principles apply:

*“... a company resides, for purposes of Income Tax, where its real business is carried on. ... the real business is carried on where the central management and control actually abides.”*

*De Beers Consolidated Mines, Limited v Howe*

A question of fact - decided on its own merits

# Qualifying Aircraft Leasing Manager

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Qualifying Aircraft Leasing Manager: a Corporation that:

- solely carries out “qualified aircraft leasing management activities” in HK
- Relevant anti avoidance provisions would not prohibit its entitlement to relevant tax concessions
- Activities that produce its qualifying profits are carried out in HK (or arranged by QALM to be carried out in HK)
- Central Management and Control
- Subject to “Safe Harbour Rules”

# “safe harbour rules” Sections 14J(2) & 14K

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“Safe harbour rules” apply to “qualifying aircraft leasing managers”

Form of anti-tax avoidance provision - allows monitoring QALM activities to ensure majority of its income generating business is conducted from Hong Kong

**≥75% threshold test** applying two formulae (both test to be satisfied):

## AMLTP Test

Aggregate “aircraft leasing management profits”

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aggregate amount of profits accruing from all sources (whether in HK or not)

## ALMA Test

Aggregate value of the “aircraft leasing management assets”

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Aggregate value of all assets, (whether in HK or not)

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**Qualifying Profits** derived from:

- (a) “qualifying aircraft leasing activity”; and
- (b) “qualifying aircraft leasing management activities”

carried out by a qualifying aircraft lessor or qualified aircraft lease manager in its ordinary course (under specified conditions) will be entitled to proposed profits tax concessions.

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**What activities qualify as:**

**“qualifying aircraft leasing  
activity”**

**&**

**“qualifying aircraft leasing  
management activity”**



# “qualifying aircraft leasing activities”

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“**qualifying aircraft leasing activity**” - section 14G(6)  
generally means:

1. activity is carried out in the ordinary course in Hong Kong;
2. aircraft is *owned* by the company; and
3. leased to a *non-Hong Kong aircraft operator*  
defined as an aircraft operator who is not chargeable to profits tax in Hong Kong (ie not a HK Airline)

Definition of “**Own**” is important – not limited to actual “ownership” of the Aircraft. Ensures proposed legislative changes apply to finance leases (ie “funding leases”), defined to “include”:

- (a) to hold as lessee under a “funding lease”
- (b) to hold as a bailee under a hire purchase agreement; and
- (c) to hold as a buyer under a conditional sale

Note – Commissioner shall be entitled to exercise discretion to determine satisfaction of “ownership” condition

# “qualifying aircraft leasing management activity”

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“**qualifying aircraft leasing management activity**” generally means:

- (a) activity is carried out in the ordinary course in Hong Kong;
- (b) activity is **carried out for another corporation** whom is a “qualifying aircraft lessor”; and
- (c) the aircraft is **owned** by the “qualifying aircraft lessor”, and is leased to a **non-Hong Kong aircraft operator**.

“**aircraft leasing management activity**” – Schedule 17F sets out a detailed list of activities

# Aircraft leasing management activities

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## B. 20% Deemed Tax Base Concession

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Taxable amount of lease payments derived from *leasing of an aircraft* to a **non-Hong Kong aircraft operator** by a **qualifying aircraft lessor** will be equal to **20% of the tax base**

tax base = gross lease payments less deductible expenses (excluding tax depreciation).

Note – Only applies to “qualifying aircraft lessors”

# Definitions: "funding lease"

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Tax concessions will also apply to applicable "finance leases" = "funding leases"

## **"funding lease" conditions:**

1. 'dry lease'
2. title will pass to the lessee at the end of the term; and
3. satisfies one (or more) of the following conditions:
  - a. Accounted for as a finance lease by HK Financial Reporting Standards or International Financial Reporting Standards;
  - b. present value of aggregate lease payments during term is no less than 80% of the fair market value of the Aircraft; or
  - c. Lease term is equal to or more than 65% of the remaining useful economic life of the aircraft.

## C. Aircraft as Capital Assets – Disposal gains not taxable – Section 14H(8)

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Aircraft leased by qualifying aircraft lessor to a non-HK operator **continuously** for a period of **3 years** will be considered a “Capital Asset” and any gains on disposal would not be taxable.

50% Profits Tax Concession also applies in relation to the leasing of the aircraft for all relevant years of assessment.





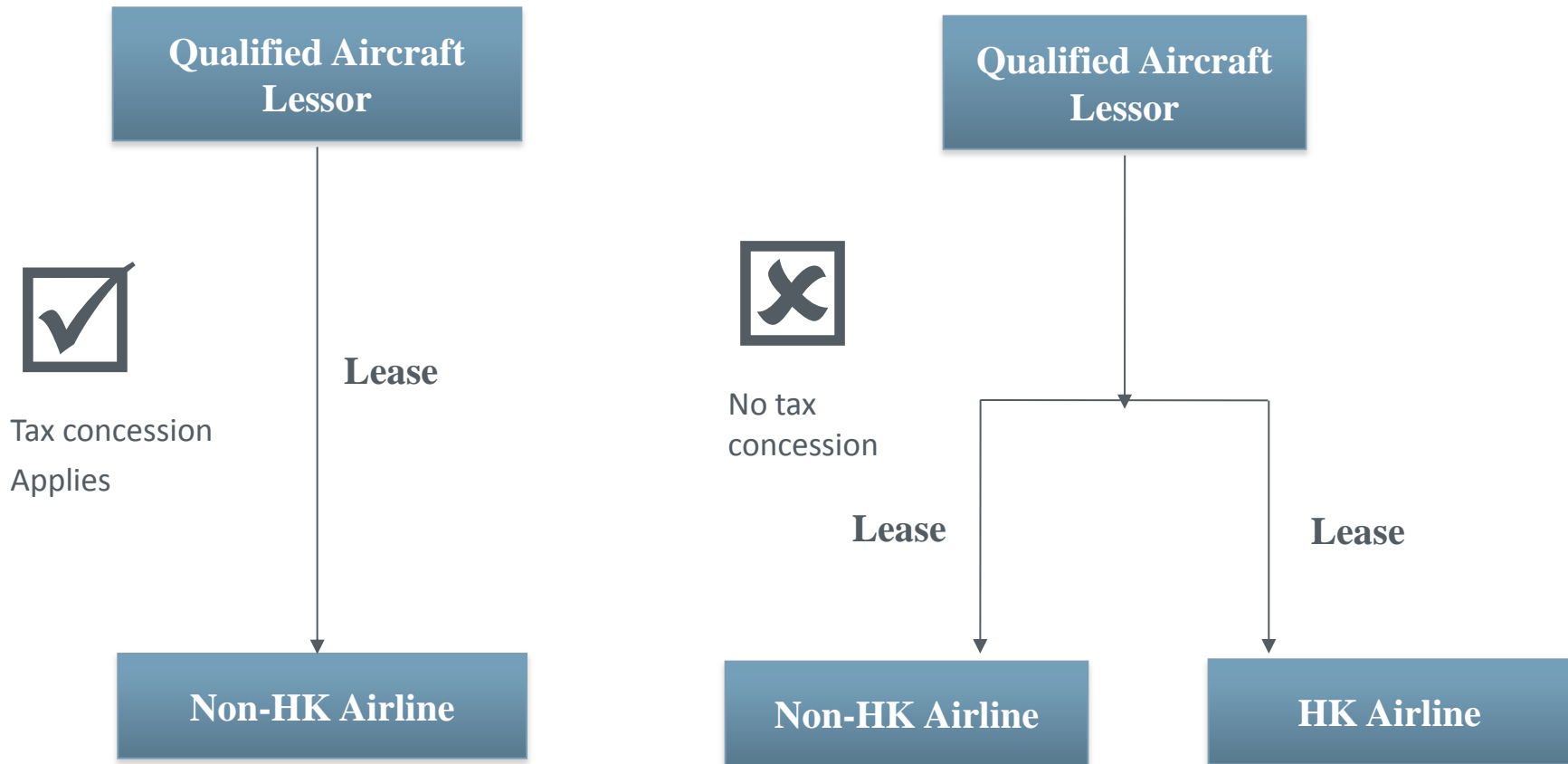
# Anti Avoidance Provisions

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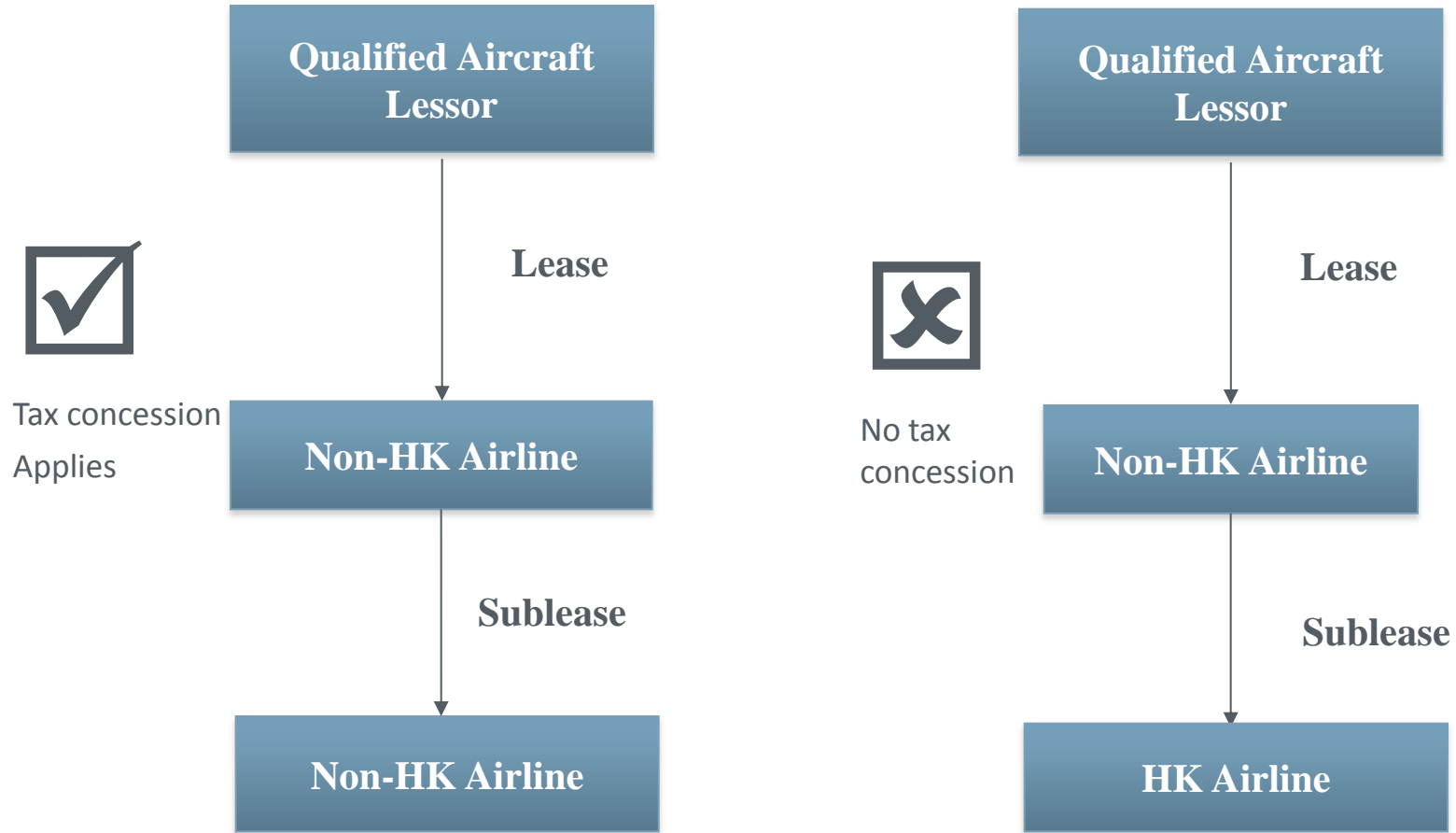
Anti avoidance provisions, if determined to apply, would effectively eliminate any tax concession benefits:

- Preferential arrangements with between qualifying aircraft lessor/leasing manager its “associates” (Section 14M(1) – (4))
- capital allowances are granted to a “connected person” of the QAL (whether in HK or outside of HK) (Section 14(I)(3))
- Aircraft is leased by QAL to a non-HK aircraft operator who subsequently subleases aircraft to HK aircraft operator and Commissioner is satisfied that one of the main purposes was to postpone or avoid profits tax (Section 14M(5))

# Practical Legal Considerations: Operating Leases

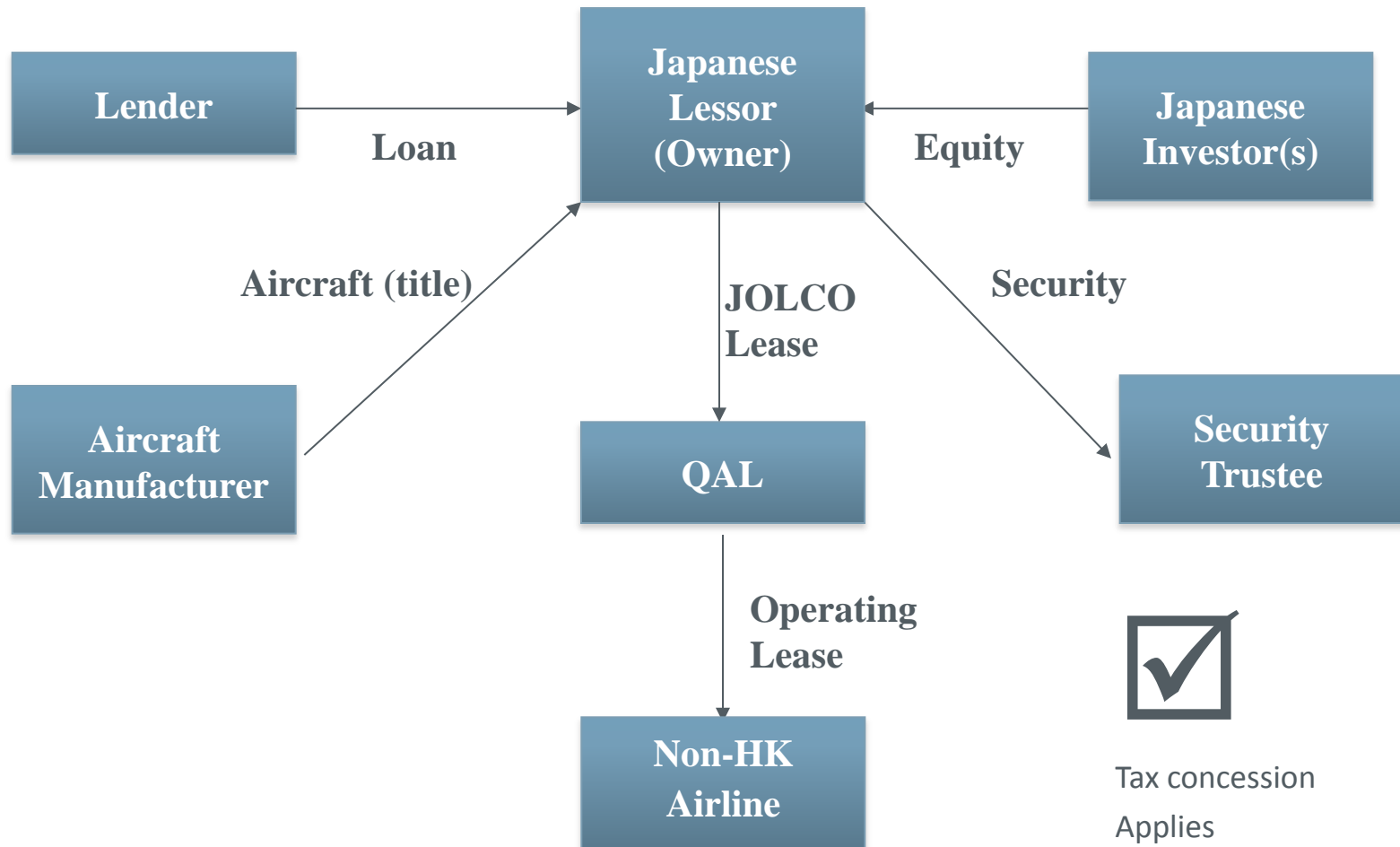


# Practical Legal Considerations: Operating Leases - Subleasing

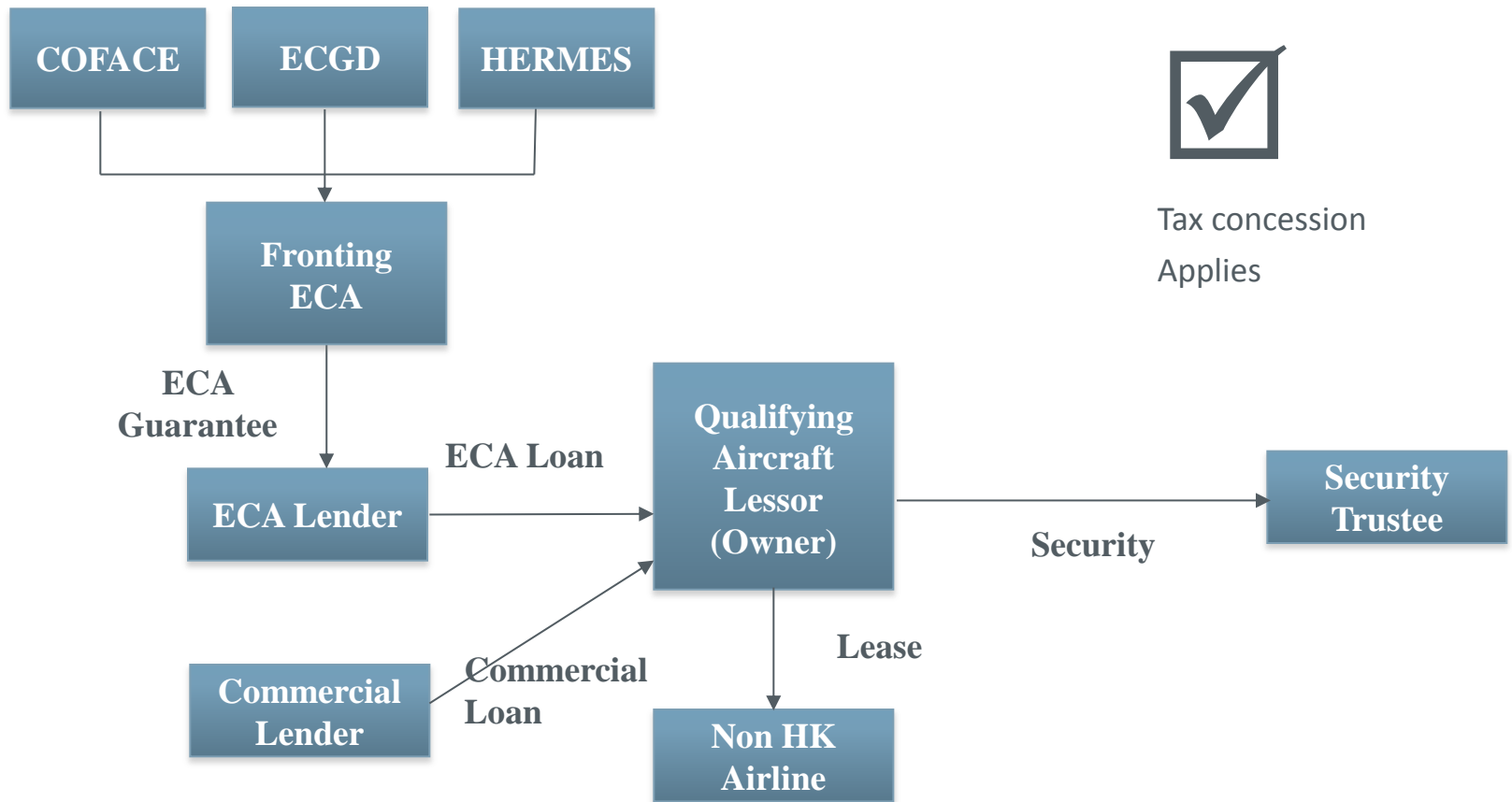


Note: subject to anti avoidance provisions

# Japanese Operating Lease

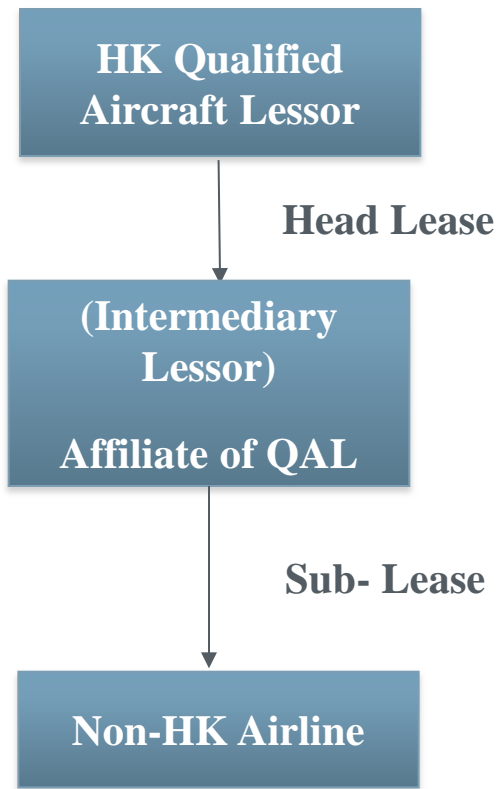


# ECA Supported Financing



# LILO Structure

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Section 14(G)(b) – requires that the aircraft is

“owned... and is leased to a non-Hong Kong aircraft operator...”.

Intermediate lessor may not be aircraft operators

Clarification to be sought



# Practical Legal Considerations

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- Lease documentation to include negative covenants to expressly prevent subleasing to a Hong Kong Airline
- Customary tax indemnity exclusion for income/profits tax of lessor to include a “carve out from the carve out” for breach of covenant re: subleasing to a HK Airline
- Tax planning to take into account common / separate HK SPCs being set up to own and lease Aircraft to non-HK Airlines (preserve tax concessions)
- Potentially new tax leasing structures to derive from new HK tax changes
- reassessment by market participants of best / prevailing tax leasing structures when leasing to certain airlines / jurisdictions – For example, foreign lessors may use Hong Kong to lease aircraft into China given DTT WHT tax rate is the lowest globally being 5%

# Conclusion

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Hong Kong, expected to be one of the worlds lowest (and arguably lowest) tax jurisdictions for aircraft financing and leasing

Low tax profit concessions resulting to an effective tax rate of 1.65%;

Transparent criteria for tax concessions

Indiscriminate – no preferences – level playing field

Effective application to existing financing and leasing structures.



# About us

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- We are an award winning legal practice providing specialist legal advice and services on all aspects relating to Asset Financing.
- One of the largest Asset Finance teams based in Hong Kong:
  - 3 Partners - 10 x Associates and 1 paralegal
- Proven track record in acting for top tier Airlines, Banks and Leasing Companies in the Asia Pacific and China

# About us

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**William Ho** specialises in aircraft finance and leasing. He has considerable expertise across a broad range of aviation transactions including export credits, tax leases, operating leases and sale and purchase of aircraft portfolios. His experience covers a variety of structures including Japanese operating leases, French tax leases, European ECA- and US Exim-backed aircraft financing, pre-delivery financing and Chinese domestic leases. William's work upon a number of innovative deals has been recognised in the AirFinance Journal's Asia Pacific Deal of the Year for each of 1999, 2001, 2002, 2005, 2009, 2010, 2011, 2012, 2015 and 2016. William is named a Band 1 Aviation Finance lawyer in Chambers Asia Pacific 2017. He is "very experienced, very strong, one of the best in the market – he can offer solutions and advice not only legally but commercially to help a client reach an agreement" (Chambers Asia Pacific).

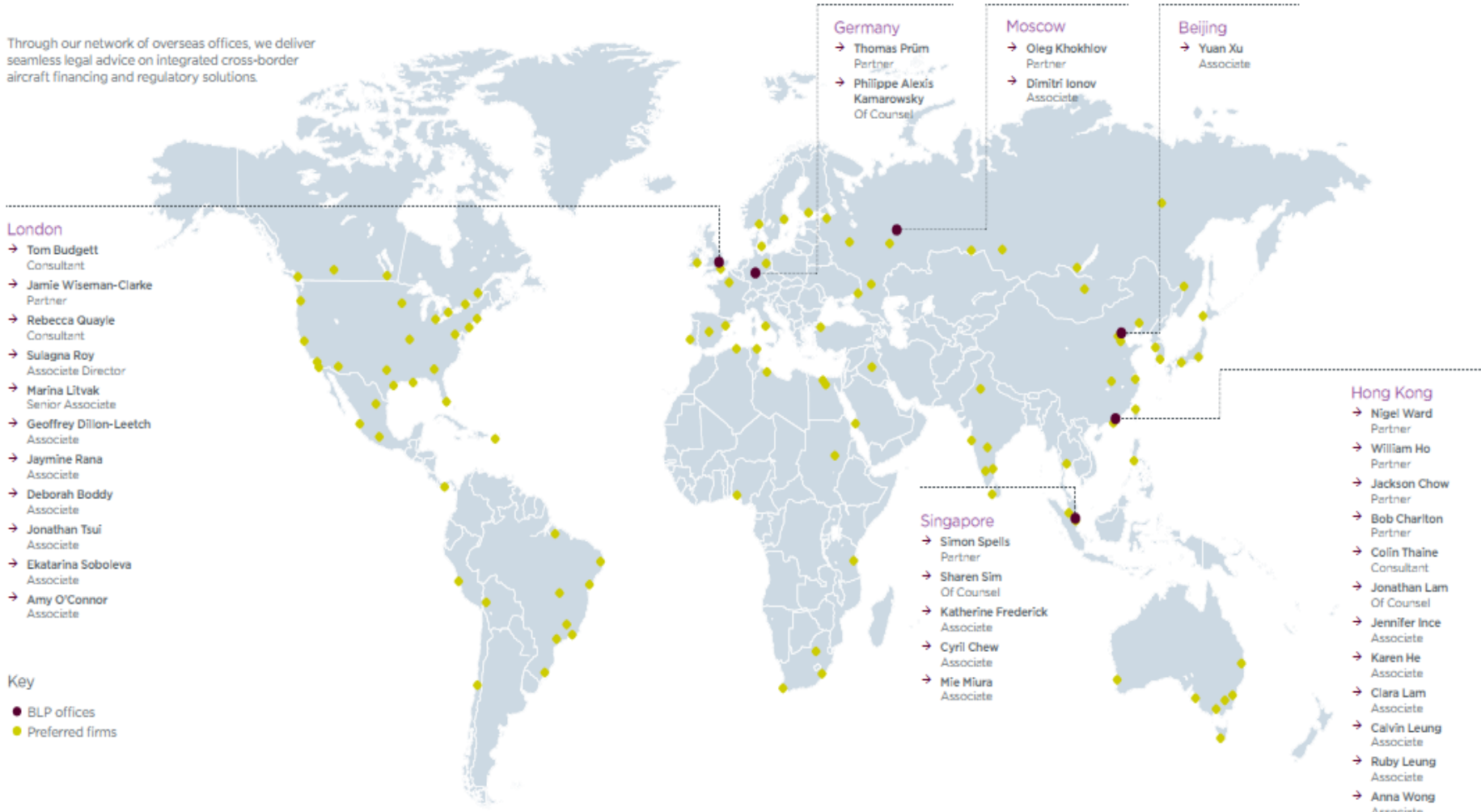
**Jackson Chow** specialises in structured asset finance and leasing with particular focus on aviation. He advises on a vast range of cross border financing and leasing structures, including JOLCOS, French tax leases, Export Credit Agency supported financings, asset backed securitizations, syndicated portfolio loans, aircraft secured bond transactions, aircraft portfolio sales, PRC SPC structured financings, sale and leasebacks, aircraft and engine operating lease transactions.

Jackson is recognised in the Chambers and Partners Asia Pacific Guide 2017 and Legal 500 and acknowledged for his ability to "input thoughts on some innovative financing structures, especially relating to structured financing transactions."



# BLP - Global support

Through our network of overseas offices, we deliver seamless legal advice on integrated cross-border aircraft financing and regulatory solutions.





# Thank you!

*This document provides a general summary only and is not intended to be comprehensive. Specific legal advice should always be sought in relation to the particular facts of a given situation.*

