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Introduction to Hong Kong's Aircraft Leasing Regime

8 May 2017

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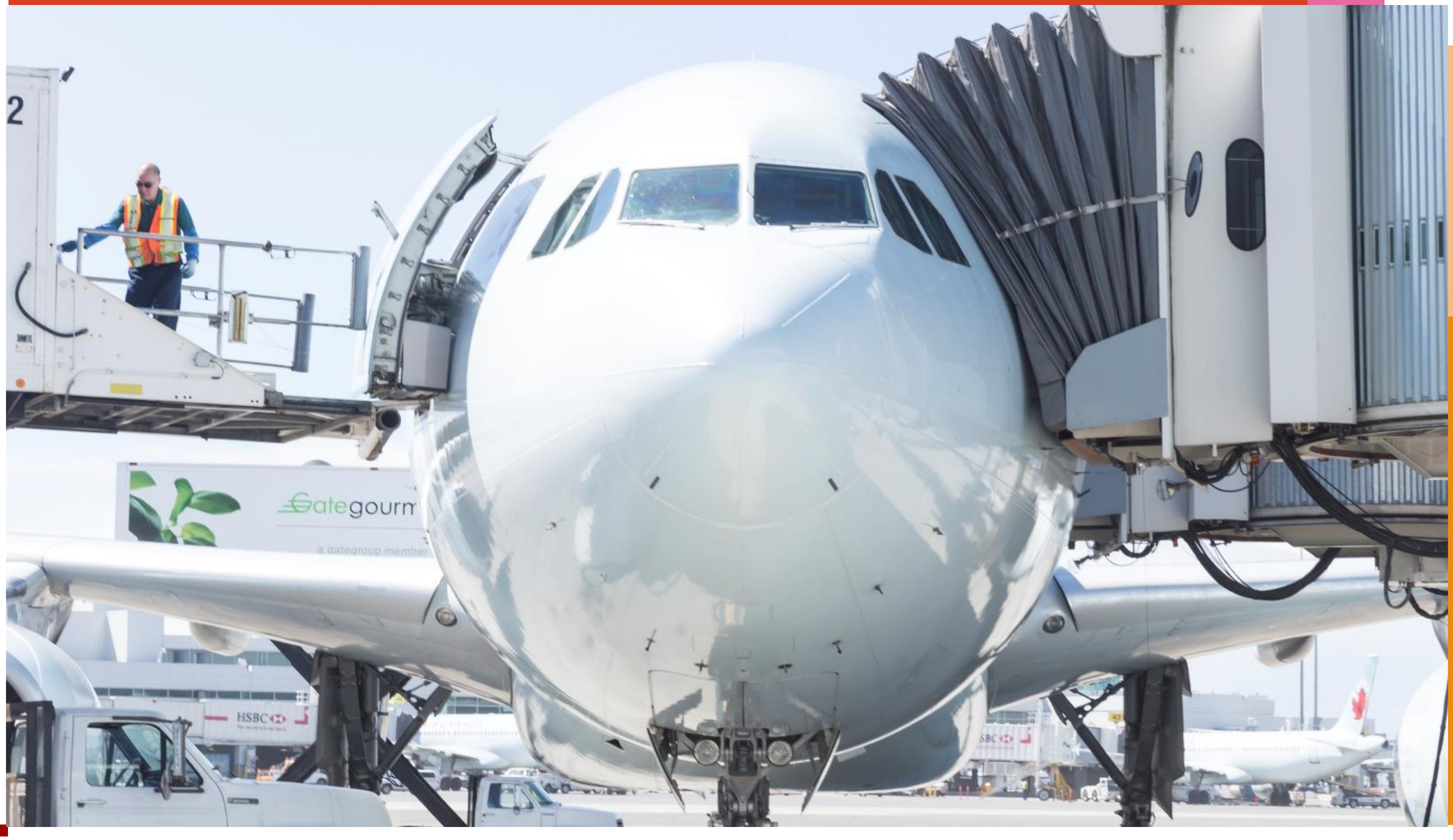

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Agenda

Section 1

Existing Hong Kong Tax Regime for Aircraft Leasing Business

Issues in the current Hong Kong tax regime

- Higher tax rate — 16.5% as against Ireland — 12.5% and Singapore — 5 or 10%
- No depreciation allowance if leased to non-Hong Kong — Hong Kong based aircraft operator
- Relatively limited tax treaty network — 37 countries* compared to Ireland — 72 countries and Singapore — 84* countries

* Including those which have been signed but yet entered into force

Effective tax rate under existing Hong Kong tax regime

Key Assumptions[1]:	
Estimated cost	US$44m
Lease Term	12 years
Annual lease rentals	US$4,489,552
Estimated Useful Life	25 years
Lease rate factor	0.85
Estimated residual value	US$22.88m
Estimated residual value	52%
Estimated funding costs	5%
Debt: Equity	75 : 25

Lessee based in Mainland China	
Consolidated lease related costs	**US$**
Withholding Tax on lease rentals	2,835,506
Lease Rentals Payable	53,874,622
Total costs to the Lessee	**56,710,128**

Applicable tax rates	
Corporation tax rate	16.50%
WHT on lease rentals[2]	5%

1. The key assumptions used for the calculations are based on a typical narrowbody aircraft
2. The withholding tax rate is based on the double taxation arrangement with Mainland China
3. The models in the presentation are for illustration purposes only

Lessor based in Hong Kong	
Consolidated Profits and Loss Account (over the lease term)	**US$**
Gross Rentals	53,874,622
Accounting Depreciation	(21,120,000)
Interest Expenses	(12,504,186)
Profits before Tax	20,250,437
Corporate Tax @ 16.50%	(6,826,122)
Profits after Tax	13,424,314
Effective tax rate	**33.71%**

Section 2

Proposed Dedicated Tax Regime for Aircraft Leasing Business

Qualifying aircraft lessors

- Not an aircraft operator;
- “Separate entity approach”; **and**
- Central management and control & profit-generating activities in HK (the “substance requirement”)

Aircraft leasing activity

- leasing an aircraft to an aircraft operator

Qualifying aircraft leasing activity

- “Own” the aircraft
- Leased to non-HK aircraft operator

Concessionary tax treatment

- 8.25% concessionary tax rate
- Assessable profits = 20% of tax base
- Capital gain exemption on aircraft disposal

Qualifying aircraft leasing managers

- Not an aircraft operator
- “Separate entity approach” (or “safe-harbor rule” or Commissioner’s determination)
- Central management and control & profit-generating activities in HK (the “substance requirement”)

Aircraft leasing management activity

- Wide range of finance/management activities

Qualifying aircraft leasing management activity

- As part of the company’s ordinary business in HK
- For a qualifying aircraft lessor
- The aircraft is owned by that qualifying aircraft lessor and leased to a non-HK aircraft operator

Safe-harbour rule

Concessionary tax treatment

- 8.25% concessionary tax rate

Specified aircraft lease management activities:

- setting up or managing a special purpose vehicle (SPV) company for (i) owning aircraft and (ii) providing guarantee to the aircraft leasing business of the company;
- arranging for the purchase or leasing of aircraft, or managing of the aircraft leasing business;
- arranging for the operation, repair and maintenance, insurance, storage, scraping and modification of aircraft;
- arranging for examining or evaluating the residual value of aircraft and the relevant equipment;
- evaluating the situation of aviation market and promoting aircraft leasing business;
- provision of financing to airline companies for acquiring the ownership of aircraft from qualifying aircraft lessors;
- providing guarantees for the residual value of aircraft or purchasing arrangements under negotiation; or
- Other related activities

Various anti-avoidance provisions:

Sums that are deductible for profits tax purposes do not qualify for the half rate **in general**

Provisions to prevent corporations to opt in when deriving profits and opt out when incurring losses

Election in writing and irrevocable

Transactions must be on an arm's length basis

Provisions to avoid round-tripping arrangements where one of the main purposes is for obtaining tax benefit

Some key observations on the concessionary tax regime:

Definitions of the terms "own" and "lease"

- "Own" includes to hold as "a lessee under a funding lease", "a bailee under a hire-purchase agreement" or "a buyer under a conditional sale agreement".
- "Lease" means a dry lease that is not a funding lease (essentially a finance lease in accordance with the accounting standards), hire-purchase agreement or conditional sale agreement, except where the Commissioner is in the opinion that the aircraft concerned would reasonably be expected NOT to pass to the lessee, bailee or buyer.

Many of the typical financing and leasing arrangements that are currently used by aircraft lessors should fall under the new regime

Some key observations on the concessionary tax regime:

Access to treaty benefits

- A network of 37 tax treaties and expanding:
  - WHT reduction or exemption on aircraft rentals
  - Some HK treaties are more favourable than other aircraft leasing hubs – e.g. China, Japan & Russia

Substance requirement

- HK aircraft lessors (often a SPV) will need to plan carefully:
  - Meet the substance requirement
  - Qualify as HK tax resident to enjoy treaty benefits

Other issues and legislative timeline

New deeming provision (S.15(1)(n))

- Sums received by or accrued to a corporation arising through or from the carrying on in HK of an aircraft leasing business or aircraft leasing management business → deemed as taxable
  - Applies to all aircraft lessors, not just qualifying aircraft lessors
  - Place where the aircraft is used or registered not determinative of the source

Legislation timeline and effective dates

- Introduction to the Legislative Council on 22 Mar 2017
  - Concessionary tax regime: YoA 2017/18
  - Deeming provision: commencement date of the Amendment Ordinance

Section 3

Q&A

Thank you!