



## Hong Kong Tax Newsflash

### Enhancements of the aircraft leasing preferential tax regime

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The draft legislation<sup>1</sup> (Bill) on the enhancements of the existing aircraft leasing preferential tax regime was gazetted on 17 November 2023. The Bill aims to strengthen Hong Kong's competitiveness in the global aircraft leasing industry. The proposed enhancements include:

- **New deduction for acquisition cost:** providing qualifying aircraft lessors with tax deduction of the acquisition cost of aircraft;
- **Expanded scope of lease:** expanding the scope of the regime to include wet lease and funding lease and removing the one-year term of lease restriction;
- **Broadened coverage:** providing for a more general meaning of "aircraft leasing activity" so that the regime will cover leasing activities other than leasing aircraft to aircraft operators;
- **New deduction for interest expense:** allowing deduction of interest payable for acquisition of aircraft to a financier outside Hong Kong who is not a financial institution and may be an associate of the borrower; and
- **Prescribed thresholds for substance requirement:** prescribing threshold requirements for aircraft lessors and aircraft leasing managers qualifying for the regime to comply with the OECD's requirements.

Upon enactment of the Bill, the proposed enhancements will apply retrospectively from the year of assessment beginning on 1 April 2023.

## Background

In 2017, Hong Kong introduced the aircraft leasing preferential tax regime. Under the regime, qualifying aircraft lessors and qualifying aircraft leasing managers can enjoy concessionary tax rate of 8.25% (i.e., half of the prevailing profits tax rate of 16.5%) on profits derived from qualifying aircraft leasing activities (only dry lease, exclude funding lease, wet lease, etc.) and qualifying aircraft leasing management activities, subject to certain conditions. On the other hand, qualifying aircraft lessors can enjoy a 20% tax base concession as compensation for the lack of depreciation allowance. Effectively, the qualifying profits are only taxed at 1.65%.

Since then, there are noticeable market changes in the aircraft leasing industry in terms of leasing arrangements, lessees, source of finance, etc. In addition, the upcoming implementation of the BEPS 2.0 global minimum tax regime will also diminish the competitiveness of the existing regime.

Against the above background, the Financial Secretary announced in the 2023-2024 Budget to introduce measures to enhance the aircraft leasing preferential tax regime with a view to maintaining and improving its competitiveness. After public consultation, the Bill which seeks to implement the enhancement measures has now been gazetted.

## Proposed enhancements

Below are the key features proposed to be enhanced compared with the existing regime:

	Existing regime	Proposed enhancements
<b>1. Acquisition cost of aircraft</b>	No deduction / depreciation allowance (compensated by a 20% tax base concession)	Full tax deduction
<b>2. Covered lease</b>	Dry lease  (operating lease for a term exceeding one year)	Dry lease <sup>2</sup> , wet lease <sup>3</sup> and funding lease <sup>4</sup> (regardless of the lease term)
<b>3. Scope of aircraft leasing activity</b>	Leasing an aircraft to an aircraft operator	Leasing an aircraft to any person
<b>4. Interest expense to overseas non-financial institution / associate for acquisition of aircraft</b>	Non-deductible	Deductible  (subject to anti-avoidance provision if the lender is an associate)

5. Prescribed threshold requirements	Not specified	Specific requirements on no. of full-time qualified employees and amount of operating expenditure in HK

The enhancement measures are discussed in detail below:

- **New deduction of the acquisition cost of aircraft**

Qualifying aircraft lessor would be allowed to deduct the capital expenditure incurred in relation to an aircraft that is used for an operating lease in that year of assessment to replace the current 20% tax base concession.

As a transitional arrangement, qualifying aircraft lessor who acquired an aircraft before the year of assessment 2023/24 may opt to continue enjoying the current 20% tax base concession or switch to the new tax deduction. Once the election is made, it is irrevocable.

The purpose of introducing the new deduction to replace the 20% tax base is to tackle the potential issue arising from the upcoming BEPS 2.0 global minimum tax regime for large multinational enterprises.

Upon the disposal of aircraft, the deduction or concession (for the year of assessment 2023/24 and onwards) would be clawed back and the sale proceeds, not exceeding the amount of concession or deduction allowed, would be deemed as trading receipts chargeable to profits tax.

On the other hand, under the existing regime, the 20% tax base concession would not apply if capital allowance has been granted to a qualifying aircraft lessor or its connected person in respect of the aircraft. The Bill proposed that the same anti-avoidance provisions would apply to the new tax deduction with some carve outs where no tax avoidance is involved. For example, deduction would still be allowed where the lessor or its connected person is subject to tax outside Hong Kong and where capital allowances on an aircraft granted to the lessor's connected person outside Hong Kong have been fully clawed back.

- **Expansion of the scope of lease and removal of the one-year lease term restriction**

Under the existing regime, only the leasing of an aircraft under a dry lease that is an operating lease for a term exceeding one year is allowed.

In view of the market changes, e.g. shifting of leasing arrangements from dry leases to wet leases, increased use of funding leases to acquire aircraft and shortening of lease terms, the Bill proposed to expand the scope of lease to include both operating leases (i.e., dry

and wet leases) and funding leases and remove the one-year lease term restriction.

- **Expansion of the scope of leasing activities**

Under the existing regime, the scope of "aircraft leasing activity" covers leasing of an aircraft only to an aircraft operator.

Given that aircraft lessors now also lease aircrafts to other types of entities, including private companies, public organizations or even individuals, the Bill proposed to provide a more general meaning of "aircraft leasing activity", which will cover leasing of an aircraft to any other person.

- **New deduction of interest expense to overseas non-financial institution or associate for acquisition of aircraft**

Currently, interest expense incurred by an aircraft lessor is allowable for deduction if the money is borrowed from a lender whose interest income is chargeable to profits tax or a financial institution, or the money borrowed is wholly or exclusively used for financing the acquisition of machinery or plant which qualifies for depreciation allowance and the lender is not an associate of the borrower. In other words, the deduction is quite restrictive.

To accommodate different financing means for the acquisition of aircraft, the Bill proposed to allow deduction of interest payable on money borrowed wholly and exclusively to finance the acquisition of an aircraft used by a qualifying aircraft lessor for producing qualifying profits.

If the lender is an overseas associate of the aircraft lessor, such interest deduction will be subject to certain anti-avoidance provisions<sup>5</sup>, including subject-to-tax condition.

- **Prescribed threshold requirements**

Under the existing regime, although there is substantial activity requirement for aircraft lessors and aircraft leasing managers, there is no specific threshold.

The Bill proposed to prescribe the following threshold requirements for aircraft lessors and aircraft leasing managers:

	Full-time qualified employees in HK	Annual operating expenditure in HK
Aircraft lessors	Not less than 1	Not less than HKD 2 million
Aircraft leasing managers	Not less than 2	Not less than HKD 1 million

### Other enhancements

In addition to the above enhancement measures proposed in the Bill, the following enhancement measures have been implemented via administrative means in the first half of 2023:

- **Recognition of the Irish Stock Exchange**

To facilitate the financing of aircraft lessors through bonds or notes in asset backed securitisation structures listed in Ireland, the Irish Stock Exchange has been recognised by the Inland Revenue Department (IRD) for the purpose of interest deduction under Section 16(2)(f) of the Inland Revenue Ordinance (IRO)<sup>6</sup> starting from 1 April 2023.

- **Specification of leasing model involving bare trust**

In June 2023, the IRD updated its guidance on taxation of aircraft leasing activities<sup>7</sup> to clarify that a beneficial owner of an aircraft under a bare trust arrangement<sup>8</sup> would be entitled to the tax concessions under the existing regime and provide further guidance in this regard.

### **Our comments**

In recent years, the aircraft leasing business has evolved significantly. We are pleased to see the Hong Kong Government has taken steps to enhance the attractiveness to aircraft leasing business by revisiting the current tax regime. The proposed enhancements are comprehensive and have catered for the market changes and international tax developments. We believe the enhancement measures will strengthen Hong Kong's competitiveness in the global aircraft leasing industry.

The introduction of new tax deduction of the acquisition cost of aircraft would bring our regime in line with that of Singapore. Despite Hong Kong's concessionary tax rate (8.25%) is higher than the concessionary tax rate in Singapore (8%), our current 5% withholding tax rate with the Mainland China on aircraft lease rentals is more favourable than the 6% withholding tax rate between the Mainland China and Singapore. Hong Kong may still maintain a competitive advantage given the fast-growing civil aviation market in the Mainland.

There are significant enhancements made to the aircraft leasing preferential regime. Aircraft lessors and aircraft leasing managers should watch out for the development and seek professional advice in assessing whether they would be eligible for the tax concession under the enhanced regime.

<sup>1</sup> [Inland Revenue \(Amendment\) \(Aircraft Leasing Tax Concessions\) Bill 2023](#)

<sup>2</sup> A dry lease generally means a lease of aircraft, not including crew, insurance and maintenance.

<sup>3</sup> A wet lease is typically a short-term lease for seasonal needs including the aircraft, crew, maintenance and insurance during the period of the lease.

<sup>4</sup> A funding lease is a financing arrangement under which the lessee is transferred the risks and rewards incidental to the ownership of the aircraft and the aircraft lessor is the financier. The lessee is usually provide with an option to purchase the aircraft at the end of the lease term.

<sup>5</sup> The interest income received by the associate must be subject to similar tax outside Hong Kong at a rate not lower than the reference rate (i.e., tax concession rate of 8.25%). The associate's right to the interest would not pass to any other person, unless under an arm's length transaction and the capital expenditure qualifies for a deduction under Section 14IC of the IRO.

<sup>6</sup> Under Section 16(2)(f)(i) of the IRO, interest can be allowed for deduction if it is payable on debentures listed on a stock exchange of Hong Kong or on any other stock exchange recognised by the Commissioner of Inland Revenue.

<sup>7</sup> [Departmental Interpretation and Practice Notes No. 54](#)

<sup>8</sup> Under a bare trust arrangement, a bare trustee holds the bare legal ownership of an aircraft while the lessor acts as the beneficial owner of aircraft and carries on the qualifying aircraft leasing activities in Hong Kong.

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