



Aviation Insider

In this issue:

Legislative amendments to enhance Hong Kong's aircraft leasing preferential tax regime 1

Recap on the Hong Kong Aviation Finance Forum – December 2023 13

India and Cape Town Convention updates 15

Legislative amendments to enhance Hong Kong's aircraft leasing preferential tax regime



Clarence Leung
Partner
Asset Finance & Leasing
Tax
PwC Hong Kong



Gwenda Ho
Senior Advisor
PwC Hong Kong



Tejaswi Nimmagadda
Partner
Tiang & Partners*



Nai Kwok
Counsel
Registered Foreign Lawyer
Tiang & Partners*

In brief

Capitalising on Hong Kong's strengths in financial and logistics services, the Government introduced the aircraft leasing preferential tax regime (Regime) in 2017 to provide half rate tax concession to qualifying aircraft lessors and qualifying aircraft leasing managers.

To keep up with the latest market changes and mitigate the potential impacts of the impending introduction of a global minimum tax, the Transport and Logistics Bureau and the Inland Revenue Department (IRD) jointly issued a trade consultation paper last year to gauge the views of stakeholders on an array of measures to enhance the existing Regime.

The Inland Revenue (Amendment) (Aircraft Leasing Tax Concession) Bill 2023 (Bill), which seeks to amend the Inland Revenue Ordinance (IRO) to implement the enhancement measures, was gazetted on 17 November 2023¹.

On 21 February 2024, the Bill passed its third reading in the Legislative Council unchanged. It is expected that the Bill will be gazetted as the amendment ordinance on 1 March 2024.

The legislative amendments will take retrospective effect from the year of assessment beginning on or after 1 April 2023 (i.e. year of assessment 2023/24) upon passage of the Bill. Furthermore, the IRD has already acted upon the enhancement measures that could be implemented via administrative means earlier in 2023.

This news flash summarises the enhancement measures under the Bill and those that have been implemented by the IRD, as well as our comments thereon.

1. The Bill and the Legislative Council Brief on the Bill can be accessed via these links:
<https://www.legco.gov.hk/yr2023/english/bills/b202311172.pdf>
https://www.legco.gov.hk/yr2023/english/brief/tlb20231115_20231115-e.pdf

* Tiang & Partner is an independent Hong Kong law firm and a member of the PwC network

In detail

Enhancement measures under the Bill

Providing tax deduction of the aircraft acquisition cost

Background

Under the existing Regime, tax relief in respect of the acquisition cost of an aircraft is effectively allowed in the form of a 20% tax base concession instead of depreciation allowances or deductions². However, such a deemed tax base concession would potentially undermine the tax competitiveness of the Regime upon the implementation of the GloBE rules³ promulgated by the Organisation for Economic Co-operation and Development (OECD). This is because under the GloBE rules, where the effective tax rate (ETR) of an in-scope multinational enterprise (MNE) group on profits in a jurisdiction falls below 15%, a top-up tax will be levied to bring the overall level of taxation up to the 15% minimum rate. The top-up tax can be levied by one or more jurisdictions outside of Hong Kong where the ultimate parent entity and/or other constituent entities of the group are located, and by Hong Kong when it introduces a qualified domestic minimum top-up tax (QDMTT)⁴.

In computing the jurisdictional ETR, any deferred tax adjustment that addresses temporary difference in the recognition of income and expense for accounting and tax purposes (e.g. difference between accounting depreciation and tax depreciation/deduction) will be included as a covered tax (i.e. numerator), while no adjustment to either the covered taxes or the MNE group's income (denominator) can be made in respect of most permanent differences between the accounting profits and tax base (e.g. exempted income or reduced tax base).

As a result, a qualifying aircraft lessor in Hong Kong will likely have a lower jurisdictional ETR and hence, for such large MNE lessors subject to the GloBE rules/QDMTT rules, a greater amount of top-up tax would apply compared to other aircraft lessors conducting business in other jurisdictions which grant depreciation allowances or deductions for the acquisition of aircraft.

2. Under section 39E of the IRO, an aircraft lessor would be denied depreciation allowances if it leases an aircraft to a person other than a Hong Kong aircraft operator. As section 39E is a specific anti-avoidance provision enacted to guard against the abuse of depreciation allowances under certain forms of leasing arrangements in respect of machinery or plant (including aircraft), the Government considered it more appropriate to introduce a 20% tax base concession to compensate for the lack of depreciation allowances under the existing Regime. Such a level of reduced tax base was based on the understanding that 20% of net lease payments generally represented the average profit margin of aircraft leasing business.
3. The GloBE rules, an acronym for Global Anti-base Erosion rules, are designed to ensure that large MNE groups pay tax at a minimum ETR of 15% on the income arising in each jurisdiction in which they operate. The GloBE rules will generally apply to MNE groups with annual global revenue of at least Euro 750 million in two or more of the preceding four fiscal years.
4. Jurisdictions can adopt a QDMTT which will apply first before controlled foreign company allocations and application of the income inclusion rule or undertaxed profits rule under the GloBE rules. The Government has indicated its intention to introduce a QDMTT in Hong Kong from 2025.

Amendments to address concerns upon implementation of the GloBE rules

The Bill seeks to amend the IRO to replace the 20% tax base concession with a one-off tax deduction of the capital expenditure incurred for the acquisition cost of an aircraft. The proposed deduction will result in a temporary difference that gives rise to deferred tax.

Specifically, the Bill provides that subject to satisfying the relevant conditions, a qualifying aircraft lessor would be allowed to deduct the full consideration of an aircraft (including any legal expenses and valuation fees incurred in connection with the acquisition) for the year of

assessment in which the aircraft is acquired, where the acquisition takes place in or after the year of assessment 2023/24.

With respect to an aircraft that was acquired by a qualifying aircraft lessor in a year of assessment preceding the year of assessment 2023/24 and that had been used by the qualifying aircraft lessor for carrying out qualifying aircraft leasing activity relating to an operating lease in any preceding year (old aircraft), the lessor may continue to enjoy the prevailing 20% tax base concession or make an irrevocable election to switch to the proposed tax deduction. Such an election can be made in any year of assessment (not necessarily in the year of assessment 2023/24).

Upon election for the proposed deduction route, a qualifying lessor would be allowed tax deduction in respect of the residual value of the old aircraft and be assessed profits tax on its actual profits.



Circumstances under which the 20% tax base concession or proposed tax deduction will be denied

To prevent a qualifying aircraft lessor and its connected person from obtaining double benefits with regard to the acquisition of the same aircraft, the existing Regime contains anti-avoidance provisions which would deny the 20% tax base concession to a qualifying aircraft lessor for a year of assessment if, among others, capital allowances have been granted to a relevant person, i.e. the qualifying aircraft lessor or its connected person, in respect of the aircraft concerned for the year of assessment.

The Bill seeks the following amendments to the anti-avoidance provisions:

- where the capital allowances concerned are depreciation allowances provided in Part 6 of the IRO, such allowances will be regarded as not being or having been granted to the relevant person if an amount equal to the allowance has been charged to profits tax as balancing charge made on the relevant person;
- as regards capital allowances granted to a relevant person in a jurisdiction outside Hong Kong (non-Hong Kong jurisdiction), the specific anti-avoidance provisions will not apply if one of the following conditions is satisfied:

- i. the relevant person is subject to extra-territorial taxation in a non-Hong Kong jurisdiction in respect of the gross lease payments which are also subject to Hong Kong profits tax, with capital allowances taken into account in calculating the taxable profits in that jurisdiction, e.g. through a controlled foreign company regime; or
 - ii. the capital allowances on an aircraft granted to a relevant person in a non-Hong Kong jurisdiction have been fully clawed back in that jurisdiction through a mechanism similar to balancing charge under the IRO when compensation is received or when the aircraft concerned is disposed of (e.g. transferred to the lessor);
- a qualifying aircraft lessor will be denied the 20% tax base concession if prior to the carrying out of a qualifying aircraft leasing activity, the aircraft has been acquired by the lessor under a sale and lease-back arrangement, except where the aircraft was acquired by the lessor at a price not more than original cost and where the lessee, or an associate, had not been previously granted depreciation allowances under Part 6 of the IRO on the leased aircraft.

Similar anti-avoidance provisions will apply in determining the eligibility of a qualifying aircraft lessor for claiming the proposed tax deduction, with slight variations.

Our observations

Stakeholders have previously pointed out that the existing anti-avoidance provisions are too restrictive. In particular, where the capital allowances on an aircraft granted to a relevant person have been clawed back, the relevant person should not be regarded as having been granted the capital allowances. It is welcoming that the Bill seeks to make amendments to address stakeholders' concerns and carve out the circumstances under which no tax avoidance is involved.

It is worth noting that under the proposed deduction rules, even if the relevant person has not been fully clawed back in respect of the capital allowances previously granted, the qualifying aircraft lessor would still be eligible for a partial tax deduction to the extent that the capital allowances have been clawed back. This is more favourable than the treatment under the 20% tax base concession where the qualifying lessor concerned will be denied the concession without any partial relief in any particular year of assessment.

Claw-back of deduction upon disposal of aircraft

Upon disposal of the aircraft, the 20% tax base concession or one-off tax deduction (as the case may be) previously allowed would be clawed back and the actual amount of consideration for the disposal of aircraft and insurance money or other compensation (if any), not exceeding the amount of concession or deduction allowed, would be deemed as trading receipts chargeable to profits tax.

The Bill also contains provisions setting out how the actual amount of consideration are to be determined where the aircraft disposed of is an old aircraft. In general, the consideration will be apportioned so that only the portion attributable to the period during which the relevant provisions as amended and/or provided under the Bill apply to the old aircraft will be treated as the actual amount of consideration. The apportionment is necessary as there is no such claw-back mechanism under the existing Regime.

Expanding the scope of the Regime to include wet lease, sublease and funding lease, and removing the one-year term of lease restriction

Under the existing Regime, the term 'lease' is narrowly defined such that only the leasing of an aircraft under a dry lease that is an operating lease for a term exceeding one year is eligible for tax concession under the Regime. The Regime further requires the aircraft concerned to be owned by the qualifying aircraft lessor (which refers to economic ownership and covers a lessee under a finance lease, or a bailee under a hire-purchase arrangement in respect of an aircraft). At the relevant time, the Government reasoned that such an ownership requirement was necessary to prevent treaty shopping through subleasing.

To keep up with the latest development of the aircraft leasing industry, the Bill seeks to amend the definition of various terms so as to expand the scope of the Regime to cover both operating leases⁵ (both dry and wet leases, as well as subleases) and funding leases⁶.

The Bill also seeks to remove the abovementioned ownership requirement under the definition of 'qualifying aircraft leasing activity' to accommodate the inclusion of operating subleases under the enhanced Regime. Correspondingly, the definition of 'qualifying aircraft leasing management activity' will also be amended to remove the requirement that a qualifying aircraft leasing management activity must be carried out for a qualifying aircraft lessor in respect of an aircraft owned by the qualifying aircraft lessor.

New provisions are added to provide for the computation of assessable profits of a qualifying aircraft lessor under different types of lease arrangements.

-
5. An 'operating lease' is defined to mean (i) an arrangement under which a right to use an aircraft is granted by an owner of the aircraft to another person (specified head lease); or (ii) a sublease of an aircraft; and does not include a funding lease.
6. A funding lease is defined to mean:
- (a) an arrangement
 - under which a right to use an aircraft is granted by a person (lessor) to another person (lessee);
 - that satisfies one or more of the following conditions at its inception—
 - the arrangement is accounted for as a finance lease or loan by the lessor in accordance with— (I) the Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants, as in force from time to time; or (II) the International Financial Reporting Standards issued by the International Accounting Standards Board, as in force from time to time;
 - the present value of the aggregate minimum lease payments (whether or not they are periodic payments and including any sum payable under a residual value guarantee) during the term of the arrangement is equal to or more than 80% of the fair market value of the aircraft;
 - the term of the arrangement is equal to or more than 65% of the remaining useful economic life of the aircraft; and
 - under which the property in the aircraft will or may pass to the lessee, or an associate of the lessee, at the end of its term; and
 - (b) includes an agreement or any other arrangement in connection with an arrangement that falls within paragraph (a).

Expanding the scope of leasing activities to cover leasing of aircraft to non-aircraft operators

To allow flexibility for different types of aircraft leasing activities in the future, the Bill seeks to amend the definition of 'aircraft leasing activity' contained in Schedule 17F to the IRO such that it will not be confined to the leasing of aircraft to aircraft operators⁷, but will encompass the leasing of aircraft to any other person, such as private companies, public organisations and individuals.

Specifically, 'aircraft leasing activity', in relation to a corporation, means an activity comprising:

- the leasing of an aircraft by the corporation to any other person; and
- any of the following activities carried out by the corporation:
 - agreeing funding terms in relation to the lease concerned;
 - identifying or acquiring the aircraft to be so leased;
 - setting the terms and duration of the lease;
 - monitoring or revising any funding or other agreements in relation to the lease;
 - managing any risks associated with the lease or with an activity mentioned in subparagraph (i), (ii), (iii) or (iv).

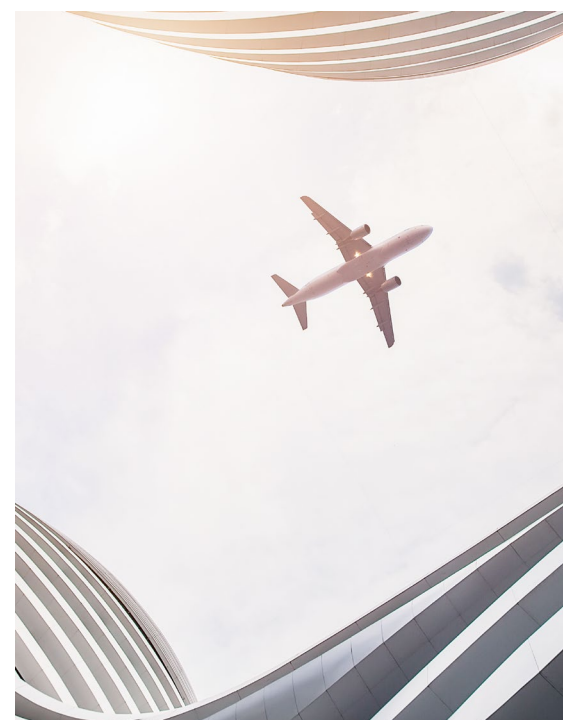
In addition, the meaning of 'aircraft leasing management activity' contained in Schedule 17F to the IRO is slightly amended by the Bill to reflect the expansion of activities that can be carried on by a qualifying aircraft lessor.

Our observations

The proposed list of activities under condition (b) above are newly added and represent the core income generating activities of a financing and leasing regime set out in the 2017 Progress Report on Preferential Regimes issued by the Forum on Harmful Tax Practices of the OECD. The inclusion of such activities will ensure that the enhanced Regime will not be considered harmful.

Allowing deduction of interest payable for acquisition of aircraft to non-financial institution financiers outside Hong Kong

The deduction of interest expense is subject to complex and stringent rules contained in section 16 of the IRO. Insofar as it is relevant, interest incurred by an aircraft lessor is allowable for deduction if (a) the interest is incurred in the production of the assessable profits of the aircraft lessor; and (b) any one of the following conditions is met: (i) the lender is chargeable to profits tax in respect of the interest derived; or (ii) the lender is a financial institution; or (iii) the money borrowed is wholly and exclusively used for financing the acquisition of the machinery or plant qualifying for depreciation allowances and the lender is not an associate of the borrower; or (iv) the interest is payable on listed or marketed debentures.



To accommodate the different financing means for the acquisition of aircraft, the Bill seeks to relax the stringent deduction conditions contained in section 16(2) of the IRO. Specifically, interest incurred on money borrowed wholly or exclusively to finance capital expenditure incurred by a qualifying aircraft lessor on the provision of an aircraft is tax deductible, provided that (i) the lender is not an associate of the borrower; and (ii) the capital expenditure qualifies for a deduction under the proposed new deduction rules and (iii) if the lender is a trustee of a trust estate or a corporation controlled by such a trustee, neither the trustee nor the corporation nor any beneficiary under the trust is the borrower or an associate of the borrower.

7. Under section 14G(1) of the IRO, an aircraft operator is defined as a person carrying on an aircraft operation business, which is a business of operating aircraft as an owner or a charterer for providing services for the carriage by air of passengers, cargo or mail, but does not include dealing in aircraft or agency business in connection with air transport.

If the financier is an **associate** of the borrower, in addition to condition (ii) above, the interest incurred is only tax deductible if the following additional conditions are satisfied:

- the associate is, in respect of the interest, subject to overseas tax which is similar to the profits tax of Hong Kong, at a rate not lower than the reference rate (i.e. 8.25%, the tax rate applicable to the qualifying aircraft lessor). For this purpose, the lender would be considered as being subject to overseas tax where the Commissioner of Inland Revenue (Commissioner) is satisfied that the relevant overseas tax has been or will be paid ('subject to tax' condition); and
- the associate's right to use and enjoy that interest is not constrained by a contractual or legal obligation to pass that interest to any other person (unless the obligation arises as a result of a transaction between the associate and a person other than the borrower dealing with each other at arm's length).

Our observations

It should be noted that the new deduction is available in respect of interest on money borrowed wholly or exclusively to finance capital expenditure (including legal and valuation fees) on an aircraft only. Where financing is needed in relation to other expenditures, e.g. working capital, separate financing arrangements (e.g. bank loans) may need to be considered.

The proposed 'subject to tax' condition is identical to that currently applicable to taxpayers seeking to claim interest expense deduction on money borrowed from a non-Hong Kong associated corporation (lender) in respect of its intra-group financing business (e.g. corporate treasury centre). However, the IRD currently adopts a stringent interpretation where the 'subject to tax' condition would only be considered as being satisfied if after deducting any direct expenses and/or tax losses,

the lender has paid or will pay tax overseas on the net interest income at a rate not lower than the applicable reference rate. That means that the lender must have or will have to pay tax overseas for the year in which the interest is derived.

Such a strict interpretation of the 'subject to tax' requirement may result in many taxpayers being unable to claim a tax deduction in respect of interest paid to their associated lender, where the associated lender is in an overall tax loss position or tax losses have been surrendered by a group company to set off against its taxable profits in the year in which the interest is derived or accrued.

Hopefully, the IRD would continue to engage with stakeholders to understand the practical implications and consider adopting an interpretation which will be conducive to strengthening Hong Kong's position as a prime aviation financing hub and enhancing the attractiveness of the existing preferential tax regime for corporate treasury centres.



Prescribing threshold requirements to comply with the requirement of the OECD

As part of the requirements of the OECD, all preferential tax regimes of Hong Kong are subject to the substantial activities requirement. This essentially requires the taxpayer to have, in the Commissioner's opinion, an adequate number of qualified employees and incur an adequate amount of operating expenditure in Hong Kong, which in any event cannot be less than the prescribed minimum thresholds.

The minimum thresholds for aircraft lessors and aircraft leasing managers proposed in the Bill are as follows:

In determining whether the minimum thresholds are met, the Commissioner will consider whether the actual number of full-time employees and amount of operating expenditure could adequately and reasonably demonstrate the fulfilment of the substantial activities requirement having regard to the facts and circumstances of individual cases. It is important for the IRD to take a pragmatic approach in looking at the 'annual operating expenditure' in this regard, given that the amount may change year by year even under the same leasing transaction and operating model (e.g. interest expenses should reduce over the life of the lease term).

Miscellaneous amendments

Gains or profits arising through or from aircraft business

- Section 15(1)(n) under the existing IRO makes it clear that sums received by or accrued to a corporation from the carrying on of certain businesses in connection with aircraft as having a Hong Kong source, even if the aircraft is used outside Hong Kong. The Bill proposes to add a new subsection 15(1DA) to clarify that section 15(1)(n) will also cover the finance charges or interest received by or accrued to an aircraft lessor under a funding lease.

	Full-time qualified employees	Annual operating expenditure
Aircraft lessors	1	HK\$2 million
Aircraft leasing managers	2	HK\$1 million

Finance charges or interest in relation to funding leases

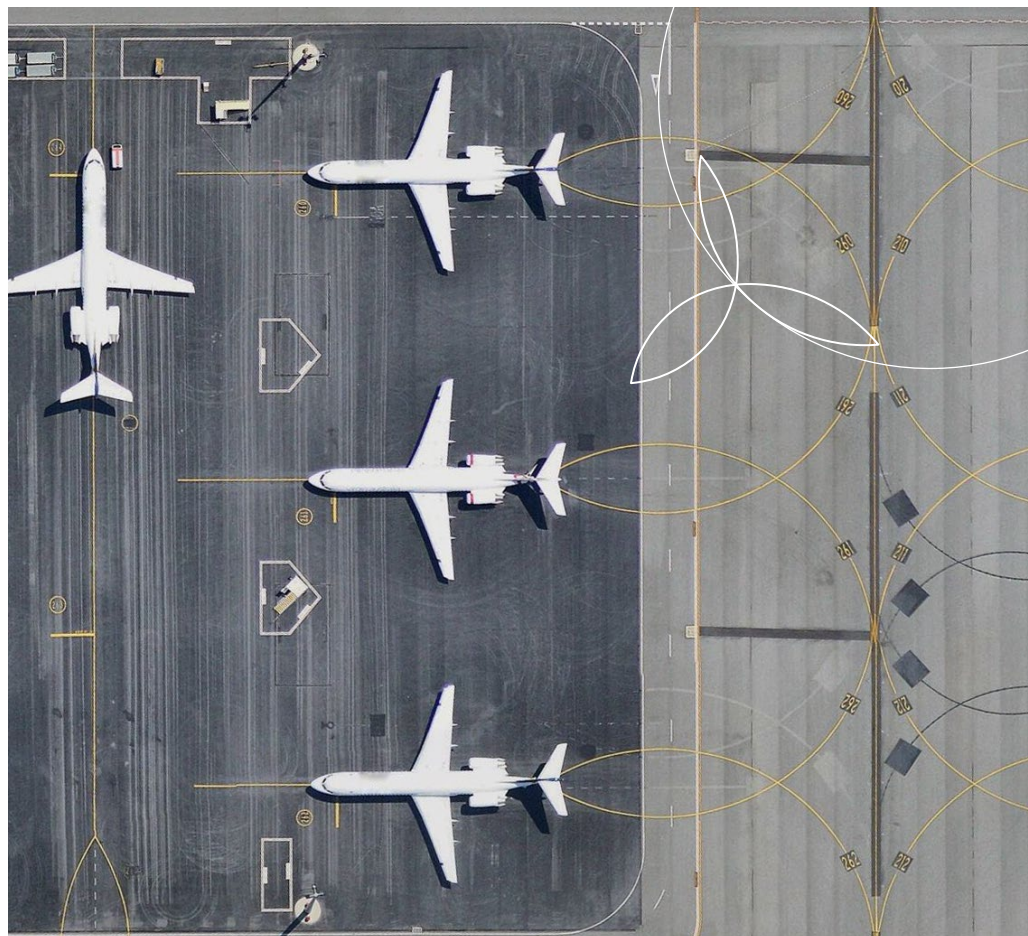
- Proposed section 15FA provides that receipts of finance charges or interest by a person in relation to a funding lease in the course of business are to be regarded as sums received by or accrued to the person by way of interest on money lent by the person.
- Proposed section 16(3CA) provides that payments of finance charges or interest by a person in relation to a funding lease in the production of profits are to be regarded as sums payable by way of interest on money borrowed by the person for the purpose of producing the profits.

Succession of an aircraft in a qualifying (court-free) amalgamation

- The Bill seeks to add a new Schedule 57 to the IRO to provide for the tax treatment in respect of an aircraft succeeded by a qualifying aircraft lessor from an amalgamating company pursuant to a qualifying court-free amalgamation under the Companies Ordinance.

Deemed sale and purchase of an aircraft upon transfer or succession without sale

- The Bill seeks to amend the relevant provisions under the existing IRO to ensure that the provisions on deemed disposal and purchase of specified assets in a specified event⁸ will apply to an aircraft in respect of which a deduction has been allowed under the proposed deduction rule.



8. Where there is a transfer or succession of a specified asset in a 'specified event', the transferor is deemed to have sold the specified asset at market value, subject to capping the value at a certain amount. On the other hand, the transferee/successor of the 'specified asset' in a specified event is deemed to have purchased the 'specified asset' at the same amount.

A 'specified event' in relation to a person refers to either (1) the transfer of the person's specified asset to another person without sale (e.g. a gift), other than by way of succession on a person's death or a qualifying amalgamation or (2) the succession to the person's specified asset by another person through a qualifying amalgamation in respect of which no election has been made to adopt the special tax treatments under Schedule 17J.

Effective date

Upon the passage of the Bill, the legislative amendments will take retrospective effect from the year of assessment beginning on or after 1 April 2023 (i.e. year of assessment 2023/24).

Appendix to this news flash summarises the changes to the existing Regime proposed under the Bill.

Enhancement measures implemented via administrative means

In addition to the above legislative proposals, the IRD has already implemented the following two enhancement measures:

Recognition of the Irish Stock Exchange for interest deduction under section 16(2)(f)

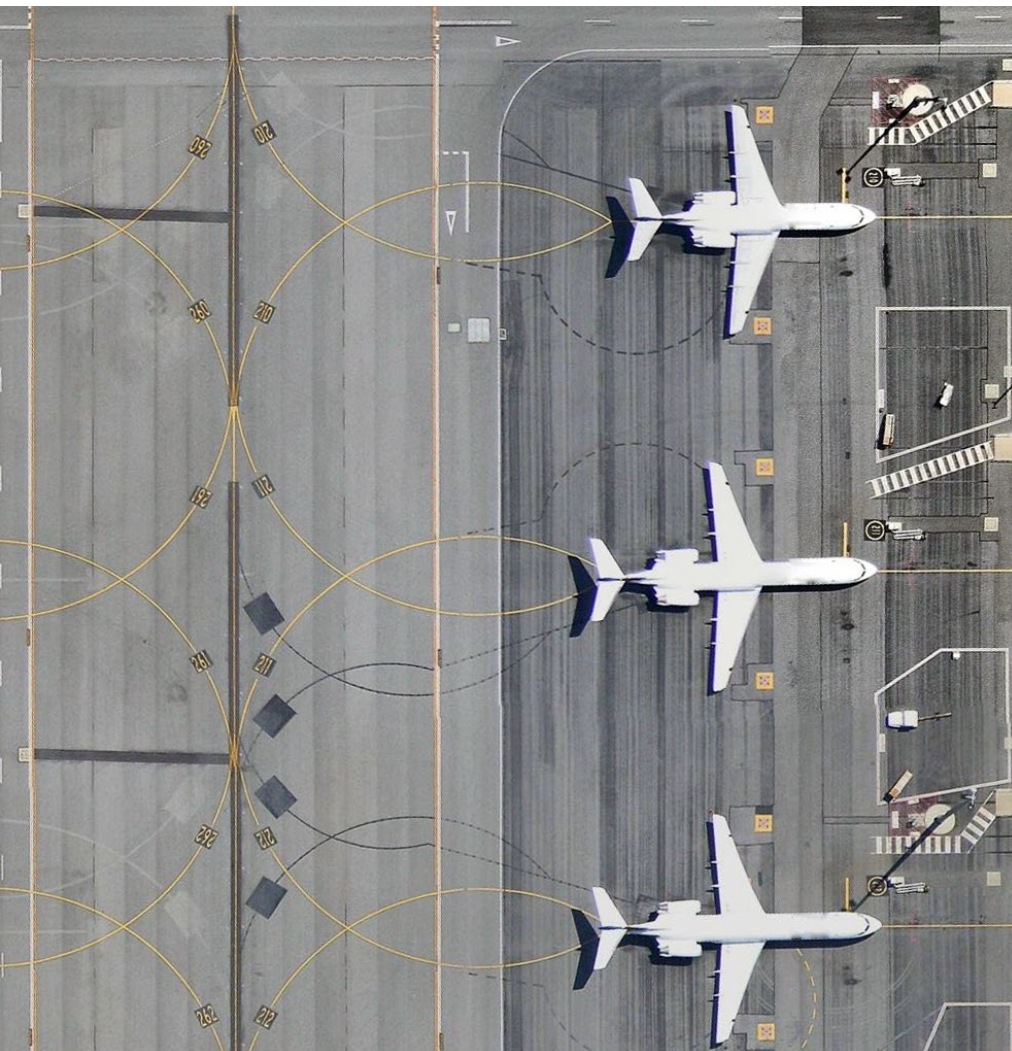
Under section 16(2)(f)(i) of the IRO, interest can be allowed for deduction if it is payable on debentures listed on a stock exchange in Hong Kong or on any other stock exchange recognised by the Commissioner.

Given that many aircraft leasing groups raise bond financing or have notes in asset backed securitisation structures which are listed in Ireland, the Commissioner has recognised the Irish Stock Exchange such that starting from 1 April 2023, interest payable on notes listed on the Irish Stock Exchange are allowed for deduction (provided that the other deduction conditions are satisfied).

Specification of leasing model involving bare trust

The use of bare trustee for holding the legal ownership of an aircraft is becoming increasingly popular as it facilitates the trade of the leased aircraft by transfer of beneficial ownership, without the necessity to novate the underlying lease.

While aircraft lessors that lease aircraft via a bare trust are already eligible for tax concession under the Regime, the IRD has updated its Departmental Interpretation and Practice Notes No. 54 in June 2023 to provide clarity about such eligibility and further guidance in this regard.



The takeaway

We are pleased to see that the Government has acted on the enhancement measures outlined in the consultation paper. These enhancements are set to propel the city's status as a premier aircraft leasing and financing hub in the international arena as it significantly broadens the Regime so that it is not just restricted to commercial aircraft leasing. There should, therefore, be opportunities for other industry players such as private jet lessors and improved accessibility to a greater pool of capital providers and structures such as aircraft securitisations.

It is also encouraging to see that the Government has taken into consideration the impacts of the GloBE rules on the existing Regime. Hopefully, the Government will also assess the efficacy of other tax incentives in the post-GloBE era, in particular, the feasibility of modifying the existing enhanced tax deduction regime for qualifying research and development expenditures such that it would qualify as a qualified refundable tax credit which is treated more favourably under the GloBE rules.

In addition to the further considerations in respect of certain provisions and requirements as noted above, the Government may also need to consider allocating more resources to expedite the expansion of Hong Kong's network of comprehensive avoidance of double taxation arrangements (CDTAs).

In general, a CDTA would allow Hong Kong resident aircraft lessors to enjoy a reduced withholding tax rate in respect of the lease income generated from the leasing of aircraft. While Hong Kong has so far concluded 48 CDTAs, the current network is not broad enough when compared to other major aircraft leasing hubs such as Singapore and Ireland. As such, concluding more CDTAs with favourable terms will certainly provide an added incentive for aircraft leasing groups to set up their aircraft leasing and services hub in Hong Kong.

PwC made a detailed submission to the Bills Committee providing technical consideration and seeking clarifications on certain provisions of the Bill. Please contact your PwC contact to discuss clarifications sent to us by the administration in response to our observations.

If you have any questions regarding the Bill, or its impact on your operations, please do not hesitate to reach out to us.

Appendix – Comparison of the tax treatments under the existing law and proposals under the Bill

	Existing law	Proposals under the Bill									
Deduction of aircraft acquisition cost	<ul style="list-style-type: none"> No deduction of aircraft acquisition cost 20% tax base concession, i.e. taxable amount of lease payments equal to 20% of the tax base, i.e. gross lease payments less deductible expenses (excluding depreciation allowances) 	<ul style="list-style-type: none"> Aircraft acquired before the year of assessment 2023/24: <ul style="list-style-type: none"> To continue to be taxed on 20% tax base concession; or To be taxed on actual profits with deduction of the residual value of the aircraft upon making an irrevocable election Aircraft acquired in or after the year of assessment 2023/24: <ul style="list-style-type: none"> To be taxed on actual profits – an outright deduction on the acquisition cost will be available in the year in which the aircraft is acquired 20% tax base concession does not apply 									
Type of lease	Only apply to dry lease that is an operating lease	Apply to operating leases (dry and wet leases), operating subleases and funding leases									
Lease term	Not less than 1 year	No restriction									
Leasing activities	Confined to leasing of aircraft to aircraft operator	Lease of aircraft to any other person									
Interest payable to non-financial institution financiers outside Hong Kong	Generally non-deductible	<ul style="list-style-type: none"> Allowable if the loan is wholly or exclusively used to finance capital expenditure incurred for the acquisition of aircraft Additional conditions have to be satisfied if the financier is the aircraft lessor's associate 									
Threshold requirements for aircraft lessors and aircraft leasing managers	Not prescribed in law	To prescribe the threshold requirements: <table border="1" data-bbox="748 1311 1471 1540"> <thead> <tr> <th></th> <th>Full-time qualified employees</th> <th>Annual operating expenditure</th> </tr> </thead> <tbody> <tr> <td>Aircraft lessors</td> <td>1</td> <td>HK\$2 million</td> </tr> <tr> <td>Aircraft leasing managers</td> <td>2</td> <td>HK\$1 million</td> </tr> </tbody> </table>		Full-time qualified employees	Annual operating expenditure	Aircraft lessors	1	HK\$2 million	Aircraft leasing managers	2	HK\$1 million
	Full-time qualified employees	Annual operating expenditure									
Aircraft lessors	1	HK\$2 million									
Aircraft leasing managers	2	HK\$1 million									

Recap on the Hong Kong Aviation Finance Forum – December 2023

PwC Hong Kong

The Hong Kong Aviation Finance Forum 2023, organised by the Hong Kong Aircraft Leasing and Aviation Finance Association (HKALA) and supported by the Hong Kong SAR Government, was the first major airline industry event to be held after the pandemic.

Opening address

At the opening address, Mr Liu Chun San, JP, the Acting Secretary for Transport and Logistics, highlighted the aviation industry's crucial role in facilitating global connectivity and economic growth. Mr Liu saw the potential for transformation and innovations in aircraft leasing. He stressed that the Hong Kong SAR (HKSAR) Government is determined to act fast and review its policies in response to changes in the environment, such as the shift in demand for airlines and the discussions surrounding BEPS 2.0. He emphasised that the HKSAR Government is fully committed to enhancing Hong Kong's competitiveness in the global aircraft leasing industry, and is confident that industry players would make the most of the vast potential and benefits that Hong Kong has to offer. Mr Benjamin Chan, JP, from the Inland Revenue Department, introduced the Government's proposed implementation framework for the minimum top-up tax in Hong Kong and shared the proposed amendments to enhance the aircraft leasing regime. These amendments aim to create a more favourable environment for the aircraft leasing industry in Hong Kong. The impact of the Pillar Two framework on aircraft leasing companies was also discussed.

Impeding the recovery of aircraft leasing market ahead

Ms Haiyan Zheng from Clover Aviation Capital, Mr Hani Kuzbari from Novus Aviation Capital, Mr Pascal Touin from CDB Aviation, Mr Tao Wang from CCB Shipping and Aviation Leasing Corporation, and Mr John Duffy from SKY Leasing, shared their views on the outlook for the aircraft leasing market after the pandemic and the challenges to the recovery of the aircraft leasing market. They highlighted challenges such as rising aircraft values and operating costs, difficulty in meeting airlines' high interest rate expectations, and the need for specialists. But, at the same time, they endorsed the generally optimistic views regarding the recovery of the aircraft market. They also highlighted the advantages of Hong Kong, such as its central location, strong financial resources, proximity to Chinese mainland, and supportive policies. Overall, they believe Hong Kong has significant opportunities in the leasing market and they encourage the development of local talent and the establishment of long-term policies to foster growth.

Aircraft finance market update and outlook on aviation market

Mr Ben Faires, from Boeing, and Ms Ada Li, from Airbus China, provided valuable insights into the state of aircraft financing and the landscape of the aviation industry. Despite the challenges and uncertainties arising from the pandemic, deliveries have gradually increased over time. The industry was expected to reach around \$94 billion in deliveries in 2023. They expressed optimism for the high demand for more fuel-efficient, new technology aircraft driven by ESG factors. They also highlighted the importance of leasing companies, anticipating that they will play a bigger financing role as deliveries expand to growing markets. They also noted that lessors have financed over 60% of deliveries recently, as airlines have regained profitability as domestic traffic surpasses 2019 levels. They saw stronger growth in Asia and Middle East, particularly China and India.

Alternative financing: a new source of fund raising and investment wellspring

Mr King Leung from Invest Hong Kong, Dr Florian Spiegl from EVIDENT Ltd, Mr Bertrand Rovetto from Crédit Agricole Corporate and Investment Bank (Crédit Agricole CIB), and Ms Trevina Talina from PwC Singapore, shared their views on key topics such as alternative funding, tokenisation and digitalisation. They emphasised the government's focus on green finance, fintech, and alternative investments to attract family offices. There were discussions about the potential of digitalisation and tokenisation to tap into untapped alternative investment capital. They highlighted the importance of ESG in aviation financing and Crédit Agricole CIB closed a sustainability-linked aircraft financing for Cathay Pacific in early 2023. They also explored the growing interest in aviation funds and the potential for collaboration between Hong Kong SAR and Singapore investors. These insights into avenues to solidify Hong Kong's role in attracting capital and promoting excellence in finance through innovation, ESG integration, and expanding investment opportunities were well appreciated by the attendees.

Closing remarks

In his closing remarks, Mr Stanley Hui thanked participants and emphasised Hong Kong's potential as an aircraft leasing and financing centre, given government support and its niche in the Asia Pacific market. However, he stressed the need to attract talent, explore tax agreements under the Belt and Road Initiative, and make Hong Kong's platform more attractive through favourable withholding tax regimes. While recognising setbacks from COVID-19 and social incidents, Mr Hui encouraged lessors and financiers to expand in Hong Kong SAR based on Chinese Government's commitments. He expressed gratitude to the sponsors and his hopes for the forum's discussions to inform future policies to enhance Hong Kong's competitiveness. He invited all to join the association in supporting the industry's development and Hong Kong's path.

India and Cape Town Convention updates



Tejaswi Nimmagadda
Partner
Tiang & Partners*



Nai Kwok
Counsel
Registered Foreign Lawyer
Tiang & Partners*

India's Compliance Index

The way down...

Since our last Aviation Insider reporting on the Go First insolvency¹, there have been a number of developments worth reporting on.

As mentioned in our previous article, the Aviation Working Group (AWG) had expressed concerns and put India on the AWG's non-complying watchlist. On 25 September 2023, AWG put out a watchlist notice (Watchlist Notice Update No. 2) which announced that India's compliance rating would be downgraded from Medium (63.5) to Low (50).

This was primarily driven by the lack of implementing legislation to fill perceived gaps in India's ratification of the Cape Town Convention (CTC). The AWG noted that the lack of express legislation to give the Cape Town Convention primacy over domestic Indian laws gives rise to significant uncertainties as to the scope and application of the Cape Town Convention within the overall context of Indian domestic laws. This was evidenced by the protracted delays relating to the repossession of aircraft assets by aircraft lessors in the Go First case. In that case, the delays related to, among other things, the refusal of the Directorate General of Civil Aviation (DGCA) to promptly

deregister and assist with the export of aircraft. This was due to the imposition of a moratorium by the insolvency tribunal, and the tribunal's determination that aircraft whose leases were validly terminated prior to the admission of insolvency proceedings were nevertheless subject to the statutory moratorium.

Further delays were also anticipated due to difficulties in obtaining timely hearing dates in court proceedings and the likelihood that any judgments would be appealed. At the time Watchlist Notice No. 2 was issued, the AWG noted that the delay had already gone past 130 days, which was well past the 60 day 'Alternative A' waiting period declared by India in relation to Article XI of the Cape Town Convention.

1. Aviation Insider - PwC Aviation Newsletter September 2023: <https://www.pwccn.com/en/industries/aircraft-leasing/aviation-insider-newsletter-sep2023.html>

... and up?

Following the issuance of Watchlist Notice No. 2, the Indian Central Government issued a notification on 3 October 2023 (pursuant to its power under section 14 (3)(a) of the Insolvency and Bankruptcy Code) that the statutory moratorium under the Insolvency and Bankruptcy Code (IBC) will not apply to 'transactions, arrangements or agreements, under the Cape Town Convention and Protocol relating to aircraft, aircraft engines, airframes and helicopters'.

It is expected that this notification will have the effect of disapplying the moratorium with respect to any aircraft objects which are covered under the Cape Town Convention. It is expected to resolve a significant area of concern and non-compliance with India's obligations under the Cape Town Convention as highlighted in the Go First insolvency proceedings (namely, the imposition a statutory moratorium with respect to aircraft objects beyond the 60-day waiting period allowed under the Cape Town Convention).

This notification was met with an immediate, positive response by the AWG, which issued, on 5 October 2023, a further update with respect to the notification, upgrading India's Cape Town Compliance outlook to 'positive'.

It was noted that this notification only addresses a specific issue within a specific piece of Indian legislation (the statutory moratorium imposed upon the opening of insolvency proceedings under the Insolvency Bankruptcy Code) which has resulted in significant and ongoing non-compliance with the Cape Town Convention. Therefore,

all other areas of Indian domestic law remain subject to the usual rules of statutory interpretation which, as discussed previously, mean that India's domestic laws may still prevail to the extent of any inconsistency with the Cape Town Convention in other areas.

Nevertheless, the exclusion of the statutory moratorium represents a key area of concern and a particular pain point for lessors and financiers. They have shown enormous tolerance and support for the aviation industry in general during difficult times and have participated in a large number of airline restructuring and rehabilitation procedures. However, a key aspect of the credit approval and pricing for risk is based on insolvency risk assessment, including whether secured parties will be able to repossess and remarket assets following an insolvency of the airline, and whether or not the terms of the leasing could be involuntarily modified without the consent of the creditor. To the extent India ratified the Cape Town Convention and adopted Alternative A,

creditors have made historical pricing assumptions based on the assumption that India will honour its treaty obligations (including with respect to disapplying the statutory moratorium and giving financiers certainty by adopting a hard 60-day deadline to return assets or cure defaults under Alternative A).

The notification goes a long way towards honouring these commitments and reassuring creditors that, at least in any future airline insolvency, the statutory moratorium under the IBC will not apply to their aircraft assets. It remains to be seen, however, whether the exclusion will be applied in a timely manner in the Go First insolvency proceedings (the hope and expectation of the aircraft leasing community is that it will).

We understand that the DGCA has announced that it will comply with any decision of the High Court of India in this regard, and it has made submissions to the effect that, in its view, the Notification means that the moratorium should not apply.



The High Court

In further news on this front, while the effect of the Indian Central Government's notice has not yet been considered, the High Court of Delhi was asked to issue further asset preservation directions with respect to certain aircraft leased to Go Air that were already the subject of the urgent interim injunctive relief granted by the High Court earlier this year².

This round of urgent relief was sought after a walk-around inspection of some of the aircraft revealed not only a significant deterioration in their condition (in violation of the asset preservation orders issued by the High Court). Missing parts could also be observed from the walk-around inspection (including missing side sticks and tillers from the cockpit and missing ATC Transponders). This understandably sparked concerns that the aircraft were not only being inadequately maintained, but that parts were actively being cannibalised or stolen from the aircraft. The applicants therefore brought contempt of court applications before the High Court for violation of the asset preservation orders and sought further injunction relief, including to be allowed to contract a 24-hour security service (at the lessor's own expense) to ensure the integrity of the aircraft and for Go Air to continue to maintain the aircraft as required under the original court directions earlier this year.

The applicant lessors also contended that they were not given access to the aircraft maintenance and technical records, which were necessary to identify the maintenance and preservation status of the aircraft. Go First contended that the court order only related to inspection of the 'aircraft', being a reference to the physical assets themselves and not their manual and technical records. They therefore argued that they were not required by the terms of the court order to allow the lessors access to the aircraft documents and records.

Having considered the lease documentation (and noting that the definition in the leases to 'aircraft' specification included not only the physical aircraft but also the aircraft documents) and having regard to aircraft being highly complex pieces of equipment that need to be maintained in order to preserve their value, the High Court held that their order in relation to aircraft necessarily included the aircraft documents. Go Air was therefore to give the lessors access to the aircraft documents for inspection within 14 days of the directions being issued.

While this is of course a step in the right direction, it should be noted this is precisely the type of non-compliance by airline operators that the Cape Town interim remedies are intended to address (including to deregister the aircraft and to repossess and export the aircraft following a default, and the hard 60-day waiting period in alternative A).

We understand that the lessors have now initiated contempt of court filings on the basis that Go First has failed to comply with the court orders and that these submissions were heard in December 2023 (although proceedings are still ongoing and it remains unclear as to when the High Court will hand down its final decisions.

... and back down again

As a result of the above ongoing delays, the AWG has issued a further Watchlist Notice Update No. 3 on 6 December 2023, which has again assessed India's compliance outlook as negative. While noting the positive steps made by the Indian government, the AWG's overriding concern remains that the combined set of 'actions and inactions' have led to an extremely long delay in the lessor's repossession of the assets. More concerning for the aviation community in general is the continued lack of express primacy of the Cape Town Convention. Given the lack of express primacy, there is significant concern that any changes in law or gaps would not be construed 'in conformity' with the CTC. Rather, they would have the effect of displacing the CTC, or could lead to protracted delays in repossession of aircraft assets.

2. Also discussed in the last issue of Aviation Insider: <https://www.pwccn.com/en/industries/aircraft-leasing/aviation-insider-newsletter-sep2023.html>

Advisory



Stella Fu
Central China Markets Leader,
Aviation Business Services
Leader
PwC China
+86 (21) 2323 2907
stella.fu@cn.pwc.com



Johnny Lau
Aviation Business Services
Chief Consultant
PwC Hong Kong
+852 2289 5670
johnny.lau@hk.pwc.com



Martin Lu
Aviation Business Services
Director
PwC China
+86 (10) 6533 3116
martin.y.lu@cn.pwc.com



Shanshan Wang
Aviation Business Services
Senior Manager
PwC China
+86 (10) 8553 6355
shanshan.ss.wang@cn.pwc.com



Victor Cui
Aviation Business Services
Senior Manager
PwC China
+86 (21) 2323 1290
victor.cui@cn.pwc.com

Tax



Spencer Chong
China Tax Markets Leader
PwC China
+86 (21) 2323 2580
spencer.chong@cn.pwc.com



Rex Ho
Asia Pacific Financial Services
Tax Leader
PwC Hong Kong
+852 2289 3026
rex.ho@hk.pwc.com



Clarence Leung
Asset Finance & Leasing Tax
Partner
PwC Hong Kong
+852 2289 3599
clarence.kf.leung@hk.pwc.com



Bo Yu
Tax Partner
PwC China
+86 (10) 6533 3206
bo.yu@cn.pwc.com



Vivian Gao
Tax Partner
PwC China
+86 (10) 6533 3077
yan.y.gao@cn.pwc.com



Yew Kuan Kuok
Financial Services Tax
Senior Manager
PwC Hong Kong
+852 2289 8204
yew.k.kuok@hk.pwc.com

Legal



Tejaswi Nimmagadda
Partner
Tiang & Partners*
+852 2833 4908
tejaswi.nimmagadda@
tiangandpartners.com



Michelle Taylor
Partner
Tiang & Partners*
+852 2833 4994
michelle.a.taylor@
tiangandpartners.com



Nai Kwok
Counsel
Registered Foreign Lawyer
Tiang & Partners*
+852 2289 4939
nai.kwok@
tiangandpartners.com



Chiang Ling Li
Partner
Tiang & Partners*
+852 2833 4938
chiang.ling.li@
tiangandpartners.com



Kevin Tsang
Counsel
Tiang & Partners*
+852 2833 4902
kevin.kw.tsang@
tiangandpartners.com

Sustainability



Amy Cai
ESG Managing Partner
PwC China
+86 (21) 2323 3698
amy.cai@cn.pwc.com



Qing Ni
ESG Markets Leader,
ESG - Climate and
Sustainability Lead Partner
PwC China
+86 (10) 6533 2599
qing.ni@cn.pwc.com



Cindy Ngan
Partner
PwC Hong Kong
+852 2289 2749
cindy.ky.ngan@hk.pwc.com



Cyrus Cheung
Partner
PwC Hong Kong
+852 2289 1709
cyrus.lk.cheung@hk.pwc.com

Assurance



Yvonne Kam
Assurance Partner
PwC China
+86 (21) 2323 3267
yvonne.kam@cn.pwc.com

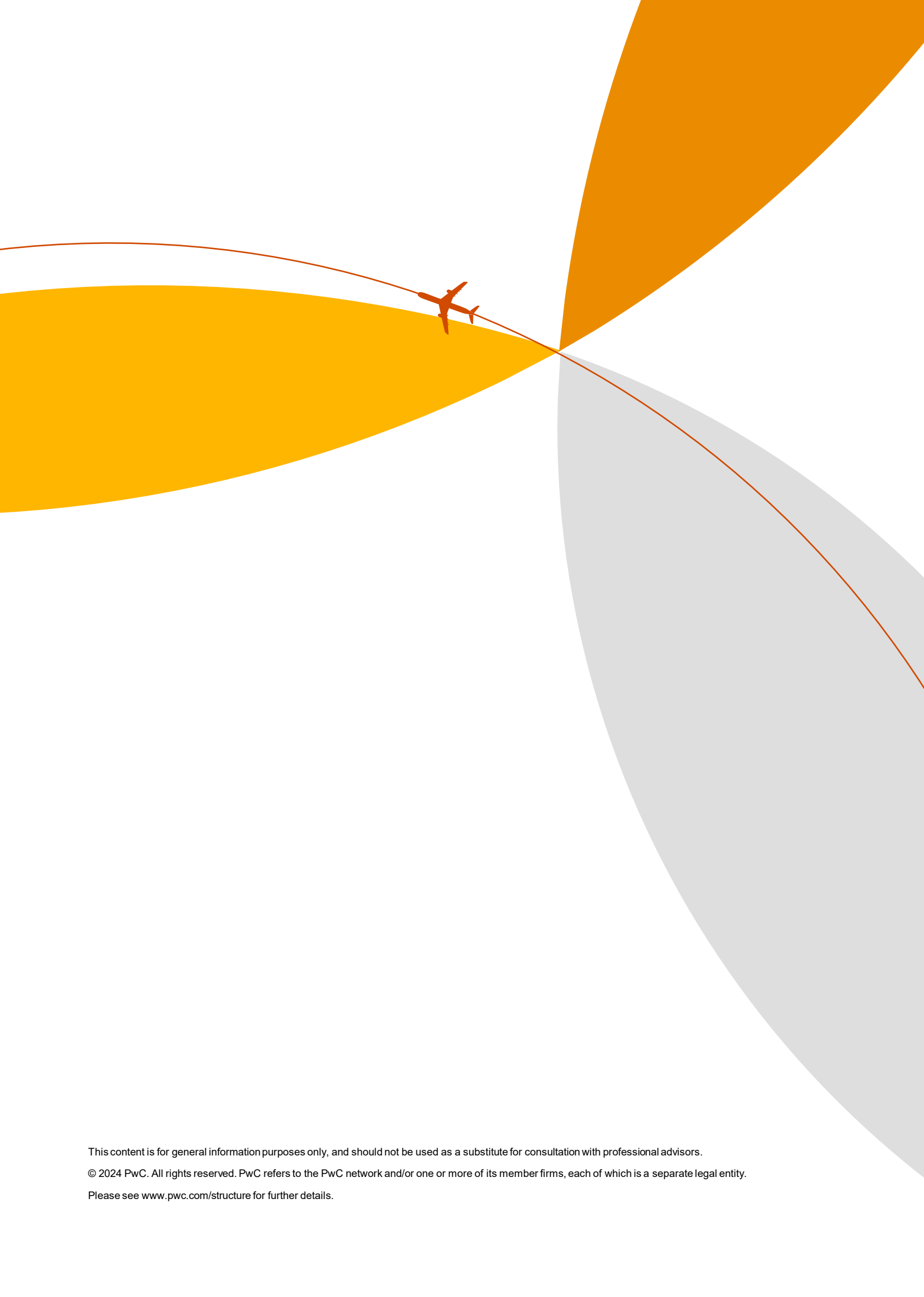


Arthur Yeung
Partner
PwC Hong Kong
+852 2289 8062
arthur.wh.yeung@hk.pwc.com

Editor-in-Chief:
Tejaswi Nimmagadda
Legal — Aircraft Finance & Leasing
Tiang & Partners*

* Tiang & Partner is an independent Hong Kong law firm and a member of the PwC network
Scan the QR code to subscribe to our newsletter:





This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

© 2024 PwC. All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity.

Please see www.pwc.com/structure for further details.