

Hong Kong gains competitive edge in cross border aircraft leasing

Hong Kong and the PRC sign agreement to reduce withholding tax on aircraft and shipping rentals from the current rate of 7% to 5%.

News Brief

On 1 April 2015, Hong Kong signed the Fourth Protocol to the Arrangement for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to Taxes on Income (the "**Protocol**") with the PRC.

One of the main advantages from the Protocol is the strengthening of Hong Kong as a hub for the booming cross border aircraft leasing market in the PRC. The advantage also extends to the Hong Kong-PRC ship chartering market.

The Protocol effectively reduces the PRC withholding tax on lease rentals in aircraft and ship leasing businesses (which are treated as royalties) from the current rate of 7% to a cap of 5%.

The reduced rate of 5 % makes Hong Kong the jurisdiction with the lowest rate of withholding applied by Chinese tax authorities on rentals paid by PRC lessees and charterers on cross border aircraft and ship leasing. Prior to the Protocol, that privileged position has been enjoyed by Singapore and Ireland, two other leading cross border leasing hubs, which have a withholding rate of 6% under their respective double tax treaties with the PRC.

Timing

It is expected that the Protocol will come into force within 2015 after the completion of the relevant ratification and notification procedures by both Hong Kong and the PRC.

Next Step

The withholding tax in addition to corporate income tax is seen to be a financial burden in the aircraft financing business. Current corporate tax rates are 16.5% in Hong Kong, 12.5% in Ireland and 10 or 5% in Singapore under an incentive scheme.

The next step will be for Hong Kong to consider amending its tax rules in order to create a more conducive tax environment for the aircraft leasing industry. Those changes may include lowering the corporate tax rate, the relaxing of the foreign interest payment deduction rules and the depreciation allowance regime.

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