

Favourable Tax Regime for CTCs in Hong Kong

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Hong Kong Government gazetted June 3 the Inland Revenue (Amendment) (No.2) Ordinance 2016 (Hereafter No.2 Ordinance) which introduces favourable tax regime for corporate treasury centres (Hereafter CTCs) in Hong Kong. This report will present the contents and key points of No.2 Ordinance.

BACKGROUND

Hong Kong, as the biggest offshore RMB centre with open foreign exchange management system embracing a variety of diversified as well as professional talents, is one of the suitable places worldwide for MNCs to establish corporate treasury centre. However, compared with Singapore who ranks top in Asia in respect of setting up CTCs, Hong Kong is less competitive at setting favourable tax regime. Moreover, for the corporations who run group-financing business, mismatch occurs between taxation on interest income and interest expenses.

With an aim of appealing more MNCs to establish CTCs in Hong Kong, the concessionary profits tax rate of 8.25% was proposed in 2015/16 Budget and reviewed by the Legislative Council late last year in order to rectify above unfavourable situation.

With the implementation of No.2 Ordinance, setting up CTC in Hong Kong appeals to MNCs in respect of favourable tax rate. In addition, as a competitive strength, Hong Kong is highly expected to expand the needs of professional talents no matter in the area of corporate management, risk management, tax, accounting or law consulting.

HIGHLIGHTS

- 1) A concessionary profits tax rate of 8.25% for certain profits derived by qualified CTCs in Hong Kong

For the qualified CTCs, a concessionary profits tax rate on qualified corporate treasury activities shall be decreased by 50% (From 16.5% to 8.25%). What's more, to enjoy the favourable tax rate, it is not necessary to apply for being a qualified CTC in advance. Instead, corporations shall choose the favourable tax rate when making a tax declaration to Inland Revenue Department (Hereafter IRD) in a given year. However, if a corporation had been a qualified CTC but fails to meet the qualifying conditions in a given year of assessment, the concessionary rate would not apply to the corporation for that year and the subsequent year of assessment.

For details please refer to table 1 below

Concessionary Profits Tax for CTCs in Hong Kong	
Application Conditions	<ul style="list-style-type: none"> ■ The central management and control(CMC) of a qualifying CTC must be exercised in Hong Kong ■ The activities that produce the qualifying profits must be carried out in Hong Kong by the corporation or arranged by the corporation to be carried out in Hong Kong
Applicable Corporations	<p>Corporations (excluding financial institutions) satisfy any of the following conditions</p> <p>① It has carried out one or more specified corporate treasury activities in Hong Kong and has not carried out any other activities in Hong Kong; or</p> <p>② It satisfies the specified safe harbour rule as discussed below; or</p> <p style="margin-left: 20px;">i. The 1-year safe harbour</p> <ul style="list-style-type: none"> ▪ The ratio between the total corporate treasury profits(CTP) and the total profits accruing to the corporation in the basis period of the year of assessment concerned is not lower than 75% and ▪ The ratio between the total value of the corporate treasury assets (CTA) and the total value of all assets of the corporation at the end of the basis period for the year of assessment concerned is not lower than 75%;or <p style="margin-left: 20px;">ii. The multiple-year safe harbour</p> <ul style="list-style-type: none"> ▪ Similar to the 1-year safe harbour except that the average CTP and CTA percentages for the current year of assessment and the preceding one or two years of assessment will be considered, depending on the duration of which the corporation has carried on a trade or business in Hong Kong <p>③ It has obtained the Commissioner’s determination that the corporation is a qualifying CTC</p>
Qualifying Corporate Treasury Activities	<p>Assessable profits are derived from</p> <ul style="list-style-type: none"> ▪ Lending of money to a non-Hong Kong associated corporation, in the ordinary course of its intra-group financing business ▪ A corporate treasury service provided to a non-Hong Kong associated corporation(qualifying corporate treasury service)* ▪ A corporate treasury transaction that is related to the business of a non-Hong Kong associated corporation(qualifying corporate treasury transaction)*
Applicable Scope	<ul style="list-style-type: none"> ■ The concessionary profits tax rate for qualifying CTCs will apply to relevant profits accrued on or after 1 April 2016

Note: * Please refer to the Appendix for details

2) Deduction of interest expenses in calculating profits tax for the intra-group financing business of corporations in Hong Kong

According to No.2 Ordinance, under specified conditions, interest expenses in respect of an intra-group financing business carried on by a corporation shall apply to rule of deduction. Furthermore, it is also noted that rule of deduction applies to not only qualifying CTCs but also the corporations who carry on an intra-group financing business in Hong Kong.

For details please refer to table 2 below

Applicable Corporation	<ul style="list-style-type: none"> ■ The borrower is a corporation carries on an intra-group financing business in Hong Kong(not limited to a qualifying CTC)
Interest Income	<ul style="list-style-type: none"> ■ Chargeable ▪ The interest income produced from financing that carried out in Hong Kong by the corporation carries on an intra-group financing business(even if the moneys in respect of which the interest is received or accrues are made available outside Hong Kong)
Interest Expenses	<ul style="list-style-type: none"> ■ Deductible (Conditions) ▪ The general expense deduction rule is satisfied (i.e. the interest expenses are incurred in the production of chargeable profits); ▪ The lender is subject to tax overseas at a rate that is not lower than reference rate (i.e.16.5% or 8.25% (whichever is applicable); and ▪ The lender is the beneficial owner of the interest income, that is, its 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 lender and a person other than the borrower dealing with each other at arm's length.
Applicable Scope	<ul style="list-style-type: none"> ■ The interest expense deduction rule will apply to interest payable in relation to an intra-group financing business from 1 April 2016

COMMENTS

MNCs are more inclined to develop multiple businesses such as share-holding, trading and marketing in Hong Kong instead of only carrying out specified corporate treasury activities. Thus it is more vital to focus on the conditions of satisfying safe harbour rule in order to qualify as a CTC.

Based on part of popular concerns, the Authority in charge expresses some comments about the favorable tax regime for CTCs. For instance, on the occasion of running re-invoice business in Hong Kong, margin from trading business shall not be seen as the profits from corporate treasury activities while the service fee of providing advice on interest rate risk or exchange risk shall be counted. Moreover, when it comes to how to define a holding company as a qualified CTC, IRD shows a point of view that dividends from subsidiaries outside Hong Kong shall be counted into the denominator of the formula as a part of total profits. In the near future, IRD will issue the Departmental Interpretation and Practice Notes (DIPN) to explain the operation of tax measures and detailed items of profits and assets mentioned in the safe harbour rule.

Based on the above, it is necessary to pay attention to the DIPN promulgated by IRD. In the meantime, MNCs are highly recommended to review current corporate treasury operation, taking into account both tax considerations and business cost in order to establish a suitable regime for corporate treasury business in Hong Kong.

APPENDIX: Contents of Corporate Treasury Services and Corporate Treasury Transactions

Corporate Treasury Services	Corporate Treasury Transactions
<p>■ Service(s) provided to a non-Hong Kong associated corporation:</p> <ol style="list-style-type: none"> ① Manage the cash and liquidity position, including cash forecasting or pooling of the associated corporation, and provide related advice ② Process payments to the vendors or suppliers of the associated corporation ③ Manage the associated corporation's relationships with financial institutions ④ Provide corporate finance advisory service, including activities supporting of the raising of capital, such as by way of debt or equity by the associated corporation; and capital budgeting for the associated corporation ⑤ Advise on the management of the investment of the funds of the associated corporation ⑥ Manage investor relations regarding the investors in the debt or equity instruments issued by the associated corporation ⑦ Provide service in relation to the provision of guarantees, performance bonds, standby letters of the credit or other credit risk instruments, or remittances to or on behalf of the associated corporation ⑧ Provide advice or service in relation to the management of interest rate risk, foreign exchange risk, liquidity risk, credit risk, commodity risk or any other financial risk of the associated corporation ⑨ Provide assistance in the merger or acquisition of a business by the associated corporation ⑩ Provide advice or service in relation to the associated corporation's compliance with accounting standards, internal treasury policies, or regulatory requirements in relation to treasury management ⑪ Provide advice or service in relation to the operations of the treasury management system of the associated corporation ⑫ Provide business planning and co-ordination, including economic or investment research and analysis for the associated corporation in connection with any of the above specified activities 	<p>■ Transaction(s) entered into by the CTC on its own account and related to the business of a non-Hong Kong associated corporation:</p> <ol style="list-style-type: none"> ① A transaction in relation to the provision of guarantees, performance bonds, standby letters of credit or other credit risk instruments in respect of the borrowing of money by the associated corporation ② A transaction investing the funds of the CTC or the associated corporation in any of the following financial instruments for managing the cash and liquidity position of the CTC or the associated corporation: <ul style="list-style-type: none"> ▪ deposits ▪ certificates of deposit ▪ bonds ▪ notes ▪ debentures ▪ money-market funds ▪ other financial instruments ③ A transaction in respect of any of the following contracts that are entered into for the purpose of hedging interest rate risk, foreign exchange risk, liquidity risk, credit risk, commodity risk or any other financial risk of the associated corporation: <ul style="list-style-type: none"> ▪ contracts for difference ▪ foreign exchange contracts ▪ forward or futures contracts ▪ swap contracts ▪ options contracts ④ A factoring or forfaiting transaction

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