國富浩華稅務（香港）有限公司
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Tax Alert

New Legislation for Corporate Treasury Centres in Hong Kong

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To provide a conducive environment for attracting multinational and Mainland corporations to centralize their treasury functions in Hong Kong, the Inland Revenue Ordinance has been amended to allow, under specified conditions, interest deductions under profits tax for corporate treasury centres ("CTCs") and reducing profits tax for qualified treasury activities by 50 percent.

On 3 June 2016, the Hong Kong Government gazetted the Inland Revenue (Amendment) (No. 2) Ordinance 2016 (the Amendment Ordinance). The Amendment Ordinance enables the deduction of interest payable on money borrowed by a corporation carrying on in Hong Kong an intra-group financing business under specified conditions. In addition, it introduces a concessionary profits tax rate at 8.25% for qualifying CTCs in respect of its qualifying profits.

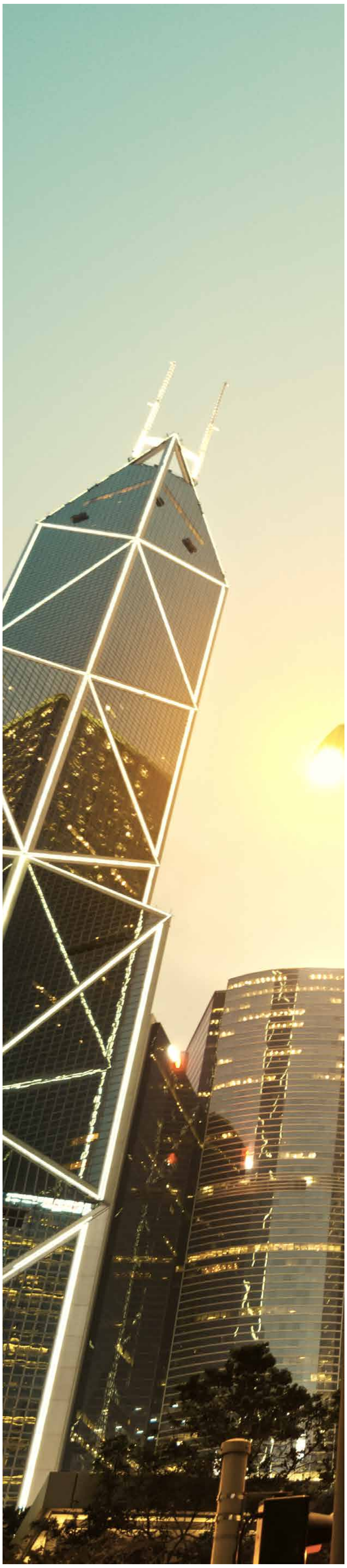
Profits Tax Concession for Qualifying Corporate Treasury Centres

Under Section 14D of the Inland Revenue Ordinance ("IRO"), a qualifying CTC is a corporation which:

i) is an entity dedicated to conduct one or more of the following corporate treasury activities:
   - Carrying on an intra-group financing business, i.e. the corporation borrows money from and lends money to its associated corporations in the ordinary course of business;
   - Providing a "corporate treasury service"; or
   - Entering into a "corporate treasury transaction".

"Corporate Treasury Services" means the following services provided to an associated corporation:

- Managing the cash and liquidity position, including cash forecasting or pooling, of the associated corporation and providing related advice
- Processing payment to the vendors or suppliers of the associated corporation
- Managing the associated corporation's relationships with financial institutions
- Providing corporate finance advisory services
- Advising on the management of the investment of the funds of the associated corporation



- Managing investor relations regarding the investors in the debt or equity instruments issued by the associated corporation
- Provision of guarantees, performance bonds, standby L/C, remittances
- Advice or service in managing interest rate risk, foreign exchange risk etc.
- Assistance in a merger or acquisition of a business
- Advice for compliance with accounting standard, internal treasury policies or regulatory requirements and
- Advisory on treasury management system

"Corporate Treasury Transactions" means entering into the following corporate treasury transactions with an associated corporation:

- Provision of guarantees, performance bonds, standby L/C in respect of money borrowed by the associated corporation
- Investing the funds of the associated corporation or itself in deposits, CD, bonds, notes, debentures, money market funds and other financial instruments
- Entering into contracts for differences, foreign exchange contracts, forward or future contracts, swap contracts, option contracts for hedging any financial risk e.g. financial exchange risk of the associated corporation; and
- Entering into factoring or forfaiting transaction

Or

ii) Satisfies the defined 1-year or multiple-year safe harbor rules (see figure below) as defined under Section 14E of the IRO, i.e. both the aggregate amount of the corporate treasury profits ("CTP") and the aggregate value of the corporate treasury assets ("CTA") for the relevant year(s) of assessment are not lower than 75% of the total amount of the profits and value of the assets of the CTC concerned;

(note: under the multiple-year safe harbor rule, 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 for which the corporation has carried on a trade or business in Hong Kong)

Figure 1: Safe harbor rules under Section 14E

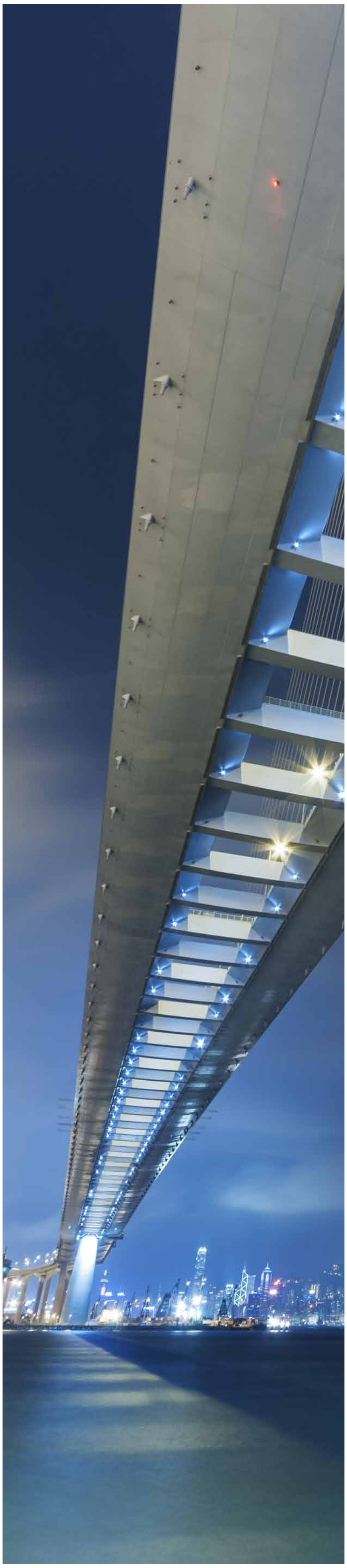
$$\frac{CTP}{P} \geq 75\% \quad + \quad \frac{CTA}{A} \geq 75\%$$

Where P = profits from all sources whether in Hong Kong or elsewhere or not
A = assets in aggregate whether in Hong Kong or elsewhere

Or

iii) Has obtained a determination from the Commissioner of Inland Revenue.

Please note that in order to be a qualified CTC, the corporation must also have its central management and control exercised in Hong Kong. In addition, the activities that generate the profits must also be either carried on or arranged by it in Hong Kong.



Financial institutions are not eligible for the above tax concession for CTCs. To enjoy the concession, the corporation has to make an irrevocable election in writing.

The concessionary profits tax rate for qualifying CTCs would apply retrospectively to relevant profits accrued on or after 1 April 2016. It is also noteworthy that the concessionary profits tax rate is only applicable to profits derived by the qualifying CTCs from one or more corporate treasury activities carried on with their non-Hong Kong associated corporations.

Interest Deductions under Profits Tax for Intra-group Financing Businesses

A new section (Section 16(2)(g)) has been added to the IRO to allow interest paid on money borrowed from a non-Hong Kong associated corporation under specified conditions.

In order to claim deduction for interest expenses incurred on money borrowed from a non-Hong Kong associated corporation, all of the following conditions need to be met:

- The money is borrowed in the ordinary course of an intra-group financing business;

- The interest received by the lender (the non-Hong Kong associated corporation) is subject to overseas tax of substantially the same nature as profits tax that has been paid or will be paid at a rate not lower than the tax rate applicable to the borrower (i.e. 16.5% or 8.25%, whichever is applicable). Please note that the lender cannot be regarded as being subject to tax in respect of the interest if the interest has been reduced to nil or a negative figure by direct expenses, including the interest expense incurred to produce the interest income;

- The lender is the beneficial owner of the interest income, i.e. its right to use and enjoy the interest is not constrained by a contractual or legal obligation to pass on the interest to another person.

To prevent the abuse of interest deduction claim under the new Section 16(2)(g), Sections 16(2CA) and 16(2CB) have been added to the IRO as specific anti-avoidance provisions. The claim for interest expense deduction can be fully or partially disallowed if:

- There is an arrangement in place whereby any sum payable by way of interest, whether directly or through any interposed person, is payable to a related person; and the related person is not subject to profits tax in Hong Kong or a similar tax elsewhere in respect of the interest; or is subject to profits tax in Hong Kong or a similar tax outside Hong Kong at a rate less than 16.5% or 8.25% (whichever is applicable) ; or

- The Commissioner is satisfied that the main purpose, or one of the main purposes, of the borrowing of the money by the corporation is to utilize a loss in order to avoid, postpone or reduce any liability, whether of the corporation or another person, to profits tax in Hong Kong.

The new interest deduction rules would apply retrospectively to interest payable in relation to an intra-group financing business on or after 1 April 2016.

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New Deeming Provisions

Section 15(1)(ia) and (la) are added to the IRO to deem the following income as trading receipts derived from Hong Kong and subject to profits tax:

- Interest income; and
- Profits from the sale or on the redemption on maturity or presentment of a certificate of deposit, bill of exchange and regulatory capital security

received by or accrued to a corporation (other than a financial institution) from its intra-group financing business notwithstanding that the incomes are of offshore source.

The new deeming provisions would apply to sums received or accrued on or after 3 June 2016.

In September 2016, the IRD published new Departmental Interpretation & Practice Notes No.52 "Taxation of Corporate Treasury Activity" to clarify and explain the practical applications of the above new rules.

Endnote

The new CTC rules are certainly helpful to strengthen Hong Kong's tax friendly business environment and enhance its attractiveness as a prime location for establishing corporate treasury hubs in the Asia Pacific region. Given Hong Kong's proximity to Mainland China and its position as the largest offshore Renminbi center, the new rules would undoubtedly reinforce the competitiveness of the Hong Kong financial markets.

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