



Hong Kong Tax Newsflash

Introduction of concessionary measures for Ship Leasing businesses

The Hong Kong government introduced the new tax incentives for ship leasing businesses with a view for Hong Kong to stay competitive in the maritime industry, to attract more renowned maritime enterprises to operate in Hong Kong and to strengthen Hong Kong's position as an international maritime and financial centre. On 17 January 2020, the Inland Revenue (Amendment) (Ship Leasing Tax Concessions) Bill 2020 (the Bill) was gazetted. This newsflash summarizes some key components of the Bill that provides profits tax concessions for qualifying ship lessors and qualifying ship leasing managers. At the same time, the Bill has introduced suitable anti-abuse features so as to comply with international tax rules and to safeguard the integrity of the tax system.

A Broad Overview

The Bill covers the following two types of activities. The key components of the proposed tax incentives relevant to each type of activities are listed below:

1. Ship leasing activity
 - This relates to the leasing of ship by a taxpayer to a ship lessor, ship leasing manager or ship operator.
 - The tax rate on the qualifying profits of qualifying ship lessor carrying on qualifying ship leasing activity (regardless of whether one is engaged in operating lease or finance lease activities) will be 0%.

- A qualifying ship lessor is defined as one that (i) is not a ship operator; (ii) carries out its qualifying ship leasing activities in Hong Kong; and (iii) one has not carried out in Hong Kong any activity other than a qualifying ship leasing activity.
- For ship leasing activity to be regarded as "qualifying ship leasing activity", the activity needs to be conducted in the ordinary course of the taxpayer's business carried on in Hong Kong; and the ship is of over 500 gross tonnage and navigating solely or mainly outside the Hong Kong water.
- For qualifying ship lessor engaging in operating lease (other than a sublease), the tax base will only be 20% of the net leasing income (with no deduction for depreciation) derived by a qualifying ship lessor.
- While for finance lease, the tax base shall mean the net finance charges or interest income received by a qualifying ship lessor (i.e. gross finance charges or interest earned by or accrued to the taxpayer after deduction of allowable expenses).
- Similar to the set-up in the aircraft leasing regime, a qualifying ship lessor should be a standalone entity that solely carry out qualifying ship leasing activities.
- Taxpayers must specifically elect in writing to be taxed under the concessionary regime. Once an election is made, it is irrevocable.

2. Ship leasing management activity

- This relates to the support services in respect of a ship leasing activity and covers a range of activities. The list of ship leasing management activities as prescribed in the Bill is provided below (*Note*).
- The tax rate on the qualifying profits of qualifying ship leasing managers providing qualifying ship leasing management activities to non-associated corporation (which is a qualifying ship lessor as mentioned above), will generally be 8.25% (i.e. one-half of the corporate Profits Tax rate).
- The tax rate on the qualifying profits of qualifying ship leasing managers providing qualifying ship leasing management activities to associated corporation (which is a qualifying ship lessor as mentioned above), will be 0%.
- A qualifying ship leasing manager is defined as one (i) not a ship operator; (ii) carries out the qualifying ship leasing management activities in Hong Kong; and (iii) other than carrying out the qualifying ship leasing management activity in Hong Kong, one has not carried out any activity.
- The Bill also lays down the safe harbour rule, which seeks to allow ship leasing managers having profits primarily from, and assets primarily for, one's qualifying ship leasing management

activities to enjoy the concessionary tax rate. In other words, the ship leasing managers may provide non-qualifying activities but yet enjoy the tax incentives, provided that the non-qualifying ship leasing management services are less than 25% of its ship leasing management activity in terms of both profits and assets (i.e. conversely, the qualifying ship leasing management services are to be at least 75% of its ship leasing management activity in terms of both profits and assets).

- Taxpayers must specifically elect in writing to be taxed under the concessionary regime. Once an election is made, it is irrevocable.

Deeming provision

Another proposed key amendment is that a deeming provision, Section 15(1)(o), is to be added. Under this provision, sums received by or accrued to a corporation from carrying on in Hong Kong a business of (a) granting a right to use a ship to another person (ship business) or (b) managing a ship business or to manage a corporation engaging in ship business, shall be deemed to be chargeable to profits tax even if the ships are used outside Hong Kong.

Anti-abuse and anti-avoidance provisions

As with all concessionary regimes in Hong Kong, there are a number of anti-abuse features and anti-avoidance provisions embedded within the Bill. The key features / measures are as follows:

- To be eligible for the concessions, both the ship lessor and ship leasing manager must have its central management and control in Hong Kong and substantial activities are conducted in Hong Kong (see related requirements in the next sub-heading). In addition, the qualifying activities are not carried out by a permanent establishment outside Hong Kong.
- For corporation that enjoys "0%" concessionary tax rate, any loss sustained by the qualifying ship lessor or ship leasing manager will not be available for set-off against one's assessable profits (if any).
- Any business transactions entered into between the qualifying ship lessor or ship leasing manager and their associated parties must be on an arm's length basis.
- The Bill also proposes that the eligibility to avail of the concessions will be subject to the "main purpose test". Broadly speaking, under the main purpose test, the profits from the relevant transaction(s) would not be eligible for the tax concession where the main purpose or one of the main purposes of the taxpayer in entering into a transaction or a series of transactions is to avoid, postpone or reduce the tax liability.
- The 20% tax base concession in respect of an operating lease will be denied if the lessor or its connected person (including

any person under a sale and leaseback arrangement) has previously claimed depreciation allowance in respect of the ship.

Substantial activity requirements

This requirement involves two conditions, namely (a) an adequate number of the full-time qualified employees; and (b) an adequate amount of operating expenditures. The proposed threshold requirements are listed below:

Type of activity	Average number of full-time employees* in HK	Annual operating expenditure incurred in HK
Qualifying ship leasing	2	HK\$7.8 million
Qualifying ship leasing management	1	HK\$1 million

* with necessary qualifications; for the basis period of a year of assessment

Effective date

Subject to the enactment of the legislation, the above proposed tax incentives would apply to sums received by or accrued to the corporation on or after 1 April 2020.

Our comments

With the introduction of the Bill, it showed that the government is taking a positive step toward making Hong Kong a ship leasing and financial hub. In particular, tax incentives extended to those carrying on qualifying ship leasing management services are welcomed.

On the other hand, under the proposed concessionary tax regime, it appears that the IRD would have taxing right over certain income where such income might not have fallen within the Hong Kong tax net previously. For example, if a corporation does carry on certain businesses in connection with ships in Hong Kong but cannot enjoy the tax incentives (as not all the required conditions under the proposed tax regime could be satisfied), will its income be subject to tax under the proposed deeming provision? Further clarification with respect to application of the deeming provision should be made.

In addition, similar to Section 23B (a mini-regime for shipping business), one should take note that the taxation rules of the proposed standalone tax regime can be rather complicated and difficulties and uncertainties may exist in the actual implementation of the regime. Proper advice is suggested to be sought as each case may be different according to its own merits.

Note: Ship leasing management activity

Ship leasing management activity is defined to include the following:

- a. managing another corporation that is a ship lessor;

- b. establishment or administration of a special purpose entity for the purpose of owning a ship by that entity;
- c. providing, or arranging for the provision of, finance in obtaining the ownership of a ship by a special purpose entity wholly or partly owned by the corporation or its associated corporation, or evaluating financial proposals from external financiers in relation to the obtaining of that ownership;
- d. providing, or arranging for the provision of, a guarantee in respect of a financial or performance obligation as regards the ship leasing business of a special purpose entity wholly or partly owned by the corporation or its associated corporation, or granting security in respect of that business;
- e. managing leases;
- f. arranging for the procurement or leasing of ships;
- g. arranging for the operation, crewing, voyage monitoring, maintenance, repair, certification, insurance, storage, scrapping or modification of ships, or the port agency services or security services for ships;
- h. arranging for the evaluation, appraisal, provision or inspection of ships or maintenance facilities for ships (including internal audits of ship quality);
- i. arranging for the assessment of the shipping market conditions;
- j. marketing of leases;
- k. providing, or arranging for the provision of, finance in obtaining the ownership of a ship by a shipping enterprise from another corporation that is a ship lessor;
- l. providing a residual value guarantee or contingent purchase arrangement;
- m. providing services in relation to a ship leasing activity for or to another corporation that is a ship lessor;
- n. overseeing the design and construction of newbuild ships.

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