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Tax Newsflash

Hong Kong Tax News:
The Inland Revenue Department Issues Guidance on Corporate Treasury Centre Rules

The Inland Revenue Department has issued new guidance [Departmental Interpretation and Practice Notes No. 52 (DIPN 52)] to clarify the provisions of the recently introduced Corporate Treasury Centre (CTC) tax regime.

The CTC tax regime was designed to increase the attractiveness of Hong Kong as a location for multinational group's treasury companies by:

1. providing for a substantial reduction in the Hong Kong Profits Tax (HKPT) rate to 8.25% (half of the standard 16.5% rate) for qualifying CTCs;
2. allowing tax deductions for interest expenses incurred by a corporation in the course of carrying on an intra-group financing business in Hong Kong; and
3. taxing interest income received by a Hong Kong corporation carrying on an intra-group financing business, even if the “provision of credit” for the loan was made outside Hong Kong.

In this Tax Newsflash, we highlight several key areas where DIPN 52 has provided additional guidance that goes beyond the wording of the legislation. Commonly asked questions will also be addressed in a further FAQ prepared by us. In the meantime, for further details on the CTC tax regime, please refer to our Tax Analysis H66/2015.

More flexibility for qualifying CTCs

In order to qualify for the reduced HKPT rate, a CTC must be either:

i. a “dedicated CTC”;
ii. a "multi-function CTC" that meets certain safe harbour rules; or
iii. a CTC that has been determined to qualify by the Commissioner of Inland Revenue.

Often of interest to our clients is whether a CTC can carry on other businesses or act as an investment holding company. However, there was previously uncertainty as to the precise operation of the "Profits Test" and "Assets Tests" contained in the safe harbour rules, which broadly require that the CTC's corporate treasury profits and assets are (on average) equal to at least 75% of the CTC's total profits and assets over a one year or multiple year period.

The IRD has clarified in DIPN 52 that the corporate treasury assets to be used in the “Assets Test” would include interest-bearing intercompany loans and receivables, cash and cash equivalents, investments made out of surplus funds for liquidity management and different hedging contracts for hedging financial risks of associated corporations.

The IRD has also clarified that a qualifying CTC could be an investment holding company within a corporate group, as dividends received from associated corporations and equity investments in associated corporations will be excluded from the calculations of the “Profits Test” and “Assets Test”.

There is still uncertainty as to whether assets, such as cash, if held for a long period of time, would represent corporate treasury assets or assets for investment holding. Also, taxpayers should be able to support that certain investments made for liquidity management purposes, which may be third party stocks, bonds, money market funds, are corporate treasury assets rather than investment assets. As such, the CTC would be advised to track and clearly earmark the assets that are corporate treasury assets for the purpose of fulfilling the Assets Test.

More certainty as to the meaning of “intragroup financing business”

A Hong Kong corporation may receive a tax deduction for interest payable to a non-Hong Kong associated corporation in respect of a loan taken out in the course of the Hong Kong corporation's "intra-group financing business" provided the corresponding interest income earned by the non-Hong Kong associated corporation is subject to tax in a foreign jurisdiction at a rate not lower than 8.25% (for qualifying income of CTCs) or 16.5% (for all other companies).

The legislation provides that intra-group financing business "in relation to a corporation, means the business of the borrowing of money from and lending of money to its associated corporations".

DIPN 52 states that whether an intra-group financing business is being carried on is a question of fact, and that factors such as the frequency, repetitiveness and amount of borrowing from and lending to associated corporations will be taken into account, along with whether commercial interest rates and payment conditions are imposed.

DIPN 52 also acknowledges that an intra-group financing business could "largely" be funded through bank finance or equity, so it should be possible for a CTC to have significantly greater intra-group lending than intra-group borrowing. However, given the wording of the legislation and the guidance, it may not be possible for a wholly bank-financed or equity-financed corporation to be considered to be carrying on an intra-group financing business, so we would recommend that a corporation seeking to fall within these provisions should incur at least some intra-group borrowings.

Reassurance that interest on simple intercompany loans will not be taxable

The guidance confirms that a corporation will only be subject to HKPT on its interest income if it is carrying out an intra-group financing business, and that the "provision of credit" test will continue to apply to simple intercompany loans not made in the course of an intra-group financing business, such that interest income from overseas affiliates would not be subject to HKPT.

As noted above, there are various factors to be considered in determining whether a corporation is carrying out an intra-group financing business, but we would expect the normal "provision of credit" rules to apply in most scenarios where a Hong Kong corporation is not regularly making new borrowings and lendings.

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