



# Inland Revenue (Amendment) (No. 4) Bill 2015

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# Background: 2015-16 Budget

- Financial Secretary announced that the Government would amend the Inland Revenue Ordinance (IRO) to-
  - allow interest deductions under profits tax for corporate treasury centres (CTCs) under specified conditions; and
  - reduce the profits tax for specified treasury activities by 50%.



# What is a CTC?

- An “in-house bank” within a multinational corporation focusing on the optimal procurement and usage of capital for the operations of the entire group
- Typical functions:
  - intra-group borrowing and lending of money
  - optimising multi-currency cash management and liquidity management
  - central or regional processing of payments to vendors or suppliers for the corporate group
  - conducting transactions for financial or treasury-related risk management
  - supporting the raising of external capital by the group



# Justifications

## (A) Revised tax rules for CTC operations

- Existing interest deduction rule is relatively less favourable for MNCs to engage in intra-group borrowing and lending of funds
- Fierce competition in the region
- Hong Kong is Asia's premier location for CTCs
- If more CTCs are established in Hong Kong-
  - create demands for financial and professional services sectors
  - contribute to the development of headquarters economy

## (B) Clarification of tax treatment for RCS

- Hybrid features of RCS (Additional Tier 1/Tier 2 instruments issued by banks for Basel III compliance) require clarifications in tax laws



# Legislative proposals

- a) Deduction of interest expense
- b) Introduction of concessionary profits tax rate for qualifying CTCs
- c) Clarification on tax treatments for RCSs issued by banks

## a) Deduction of interest expense

- Allow a corporate borrower carrying on in Hong Kong an intra-group financing business deduction of interest payable on money borrowed from a non-Hong Kong associated corporation under specified conditions
- Make it clear that interest income and specified disposal profits earned by a corporation, in respect of the intra-group financing business carried on in Hong Kong, are deemed trading receipts chargeable to profits tax



## b) Concessionary profits tax rate for qualifying CTCs

- Concessionary tax rate is 8.25% (i.e. 50% of the profits tax rate)
- Applies to qualifying profits of a qualifying CTC derived from qualifying lending transactions, or from qualifying corporate treasury services or transactions
- Qualifying CTC –
  - a standalone corporate entity engaging only in corporate treasury activities;
  - satisfies the safe harbour rule (i.e. the corporate treasury profits percentage and corporate treasury assets percentage of a corporation are not lower than 75%); or
  - Commissioner of Inland Revenue determines that a corporation is a qualifying CTC
- Anti-avoidance provisions to avoid base erosion and profit shifting (BEPS)
  - half-rate concession will apply to assessable profits in respect of which the corresponding payments made are not tax deductible in Hong Kong
  - half-rate concession will only apply to corporations with central management and control exercised in Hong Kong, and with profit-producing activities carried out in Hong Kong





## c) Clarification on tax treatments for RCSs issued by banks

- Treat a RCS as a debt security: distributions arising from the security (other than the repayment of the paid-up amount) are treated as interest for deduction and taxation under IRO
- Stamp duty relief for transfer of RCSs
- Anti-avoidance provisions
  - Arm's length principle
  - Separate enterprise principle



# Main provisions of the Bill

- Division 1 of Part 2 provides for the profits tax concession for qualifying CTCs –
  - Clause 3 –
    - defines “qualifying corporate treasury centre”;
    - provides for the safe harbour rule; and
    - provides for the CIR’s power to determine whether a corporation is a qualifying CTC;
  - Clause 4 – provides for adjustments in respect of relevant losses to be set off against the concessionary trading receipts chargeable to tax;
  - Clause 6 adds new Schedule 17B –
    - defines “corporate treasury service” and “corporate treasury transaction”
    - prescribes the minimum assets and profits percentages for determining whether a corporation satisfies the proposed safe harbour rule



# Main provisions of the Bill (con't)

- Division 2 of Part 2 provides for the tax treatment for interest income and interest expense in relation to a corporation's intra-group financing business –
  - Clause 7 – provides that the interest income and specified disposal profits earned by a corporation (other than a financial institution) in respect of an intra-group financing business are deemed trading receipts chargeable to profits tax; and
  - Clause 8 – allows deductions, by a corporate borrower carrying on in Hong Kong an intra-group financing business, of interest payable on money borrowed from a non-Hong Kong associated corporation under the specified conditions



# Main provisions of the Bill (con't)

- Division 3 of Part 2 provides debt-like tax treatments for RCSs –
  - Clause 12 – provides that distributions in respect of an RCS or profits from the disposal or on the redemption of an RCS are deemed to be trading receipts in line with the relevant existing rules
  - Clause 13 – existing section 16(1)(a) and (2)(a) (on deduction of expenses) will apply subject to the new provisions added by Clause 14



# Main provisions of the Bill (con't)

- Clause 14 –
  - treats an RCS as a debt security and a payment in respect of RCS (other than a repayment of the paid-up amount) as interest payable on the security
  - specifies the treatment of RCSs in an issuer's or its specified connected person's accounts for profits tax assessment
  - specifies the rules concerning interest deduction if an RCS is issued to or for the benefit of, or held by or for the benefit of, a specified connected person
  - specifies the application of the arm's length and the separate enterprise principles for anti-avoidance purposes



## Main provisions of the Bill (con't)

- Clauses 17 and 18 (Division 4 of Part 2) – transitional matters
- Clauses 19 to 23 (Division 1 of Part 3) – consequential amendments to the Inland Revenue Rules
- Clauses 24 to 27 (Division 2 of Part 3) – related amendments to SDO to provide for stamp duty relief for transactions and transfers relating to RCSs



# Consultation

- Briefed LegCo Panel on Financial Affairs on 1 June 2015. Panel generally supported the tax proposal for CTCs.
- Engaged treasury professionals, the tax advisory sector and the banking industry in formulating the Bill.