

LEGISLATIVE COUNCIL BRIEF

Inland Revenue Ordinance
(Chapter 112)

Inland Revenue (Amendment) (Ship Leasing Tax Concessions) Bill 2020

INTRODUCTION

A At the meeting of the Executive Council on 7 January 2020, the Council ADVISED and the Chief Executive ORDERED that the Inland Revenue (Amendment) (Ship Leasing Tax Concessions) Bill 2020 (“the Bill”), at **Annex A**, should be introduced into the Legislative Council to amend the Inland Revenue Ordinance (“IRO”) (Cap.112) to give profits tax concessions to qualifying ship lessors and qualifying ship leasing managers, to make provisions for profits tax purposes about businesses in connection with ships, and to make related amendments.

JUSTIFICATIONS

Ship leasing is an attractive business to Hong Kong

Global trend

2. Notwithstanding some fluctuations in the global shipping market in recent years, the world fleet has largely grown at a pace on par with world seaborne trade growth over a long period of time, averaging around 3% per annum from 1980 to 2018 according to the United Nations Conference on Trade and Development. With some 80% of global freight volume carried by water today, the demand for water transport will likely continue to spur demand for ship financing. The “Maritime Leasing Paper” released by the Financial Services Development Council in May 2018 estimated that the capital expenditure for newbuilding vessels was about US\$80-100 billion a year.

3. Among the different forms of ship financing, ship leasing is an emerging business model in the shipping industry compared to more traditional modes of ship financing such as bank loans. Advantages of leasing include better liquidity, greater flexibility in repayment options and

cash expenses, and lower financing costs. In particular, Chinese leasing as a source of ship finance has grown from US\$8.2 billion in 2015 to US\$20.2 billion in 2018, representing a strong growth of 35% per annum on average.

4. Given that the Organisation for Economic Co-operation and Development (“OECD”) is developing new international taxation rules and principles to deal with tax abuses, notably the anti-base erosion and profit shifting (“BEPS”) measures, some shipping and ship leasing companies are currently looking for opportunities to rebase their operations. In this connection, Hong Kong as an international maritime centre can provide a place where companies with genuine business substance can operate.

Regional landscape

5. With the shift of the global economic centre of gravity from the West to the East, and with the major contributor to shipowning and shipbuilding activities coming from Asia (e.g. around half of world’s fleet is owned by Asia where China alone accounting for 15%; China, Korea and Japan together accounted for over 90% of global shipbuilding activity in 2018), ship financing activities are expected to see faster growth in Asia. According to the Seatrade Maritime News’ estimates (May 2017), traditional banks (mainly those located in Europe) have gone from financing around 80% of the shipping industry in 2008 to about 60% in 2016, while Chinese leasing firms have expanded their market shares to about 20%.

6. Having recognised the importance of the presence of a vibrant maritime cluster in enhancing their position as major maritime centres, other international maritime cities have put forward tax measures and fiscal incentive schemes to proactively attract overseas companies to set up offices there, with a view to forming a strong maritime cluster of shipping groups and maritime services. Provision of tax incentives is a possible means for Hong Kong to stay competitive to effectively attract shipping-related companies to set up offices here.

Providing a conducive environment to promote ship leasing in Hong Kong

7. With the support of suitable policy initiatives, Hong Kong would stand to benefit from these growth opportunities. As ship leasing serves to facilitate ship ownership and operation, which also generate demand for other maritime business services, fostering the development of the ship leasing business in Hong Kong is conducive to the growth of our shipping core and maritime cluster.

8. Hong Kong has a strong maritime cluster of over 800 shipping-related companies. Among the various maritime services, ship finance has demonstrated clear growth potential, contributing more than half of the value added of the maritime services sector and registering a growth rate averaging at 9.6% per annum during 2014-2017, which far outpaced that of the maritime services sector as a whole (1.3% per annum over the same period).

9. Recognising the business opportunities arising from the growth of ship leasing as well as the competitive landscape for maritime business in the region, and having regard to the positive experience of introducing tax measures through the aircraft leasing regime, we propose to introduce profits tax concessions for qualifying ship lessors and qualifying ship leasing managers (see paragraphs 10 to 13 below) to provide a conducive environment for ship leasing business in Hong Kong. We also propose suitable anti-abuse features to guard against possible tax avoidance (see paragraph 14 below). Our vision is, through strengthening our competitiveness in attracting ship leasing activities, to enhance Hong Kong's position as an international maritime and financial centre.

The proposed dedicated tax regime

10. In order to raise the competitiveness of Hong Kong in attracting ship leasing activities and minimise the impact of the proposed tax measures on other parts of the existing tax regime, we propose providing for a new standalone tax regime under the IRO for qualifying ship lessors and qualifying ship leasing managers in which –

- (a) the tax rate on the qualifying profits of qualifying ship lessors carrying out operating lease and finance lease activities (including subleasing and sale and leaseback arrangement) will be 0%;
- (b) the tax rate on the qualifying profits of qualifying ship leasing managers carrying out ship leasing management activities for qualifying ship lessors will generally be 8.25% (i.e. half of the profits tax rate for corporations at 16.5%);
- (c) the tax base in respect of an operating lease, other than a sublease, will be equal to 20% of rentals, after deduction of expenses (excluding depreciation), derived by a qualifying ship lessor; and
- (d) the tax base in respect of a finance lease will be equal to finance charges or interest, after deduction of expenses, received by a qualifying ship lessor.

11. While setting up a special purpose vehicle with the only activity of holding a ship for leasing is a common form of structure for ship lessors in the ship finance industry, it may not be the case for ship leasing managers. Similar to the set-up in the aircraft leasing regime, a qualifying ship lessor should be a standalone corporate solely carrying out qualifying ship leasing activities, whereas for ship leasing managers, a safe harbour rule is prescribed to allow ship leasing managers having profits primarily from, and assets primarily for, their ship leasing management activities to enjoy the tax benefits. We also propose empowering the Commissioner of Inland Revenue (“CIR”) to determine that a corporation is a qualifying ship leasing manager and hence eligible for the tax concessions if the CIR is of the opinion that the relevant conditions or safe harbour rule would, in the ordinary course of its business, have been satisfied.

12. Profits derived from a qualifying ship leasing activity or ship leasing management activity carried out by a corporation under specified conditions will be entitled to the proposed profits tax concessions if the corporation makes an election in writing. The specified conditions for a qualifying ship leasing activity are –

- (a) the activity is carried out in the ordinary course of the corporation’s business carried on in Hong Kong; and
- (b) the ship is of over 500 gross tonnage navigating solely or mainly outside the waters of Hong Kong.

13. In addition to the condition specified in paragraph 12(a) above, a qualifying ship leasing management activity is subject to the following specified conditions –

- (a) the activity is carried out for another corporation during the basis period of the other corporation for a year of assessment;
- (b) the other corporation is a qualifying ship lessor for that year of assessment; and
- (c) the ship is leased by the other corporation when the activity is carried out.

Anti-abuse features

14. The dedicated regime will incorporate anti-abuse features so as to safeguard the integrity of the tax system and comply with international tax rules. The features include –

- (a) requiring qualifying ship lessors and qualifying ship leasing managers to be standalone corporate entities to prohibit loss transfer via partnership; and ringfencing the preferential tax regime to the qualifying activities;
- (b) requiring the central management and control of qualifying ship lessors and qualifying ship leasing managers to be located in Hong Kong and their substantial activities to be carried out in Hong Kong (see paragraph 15 below for the substantial activity requirements) to ensure that their business operations are domiciled in Hong Kong with substance;
- (c) denying a qualifying ship lessor the 20% tax base concession if depreciation allowances in respect of the ship have been granted to the lessor or its connected person, or granted to any person under a sale and leaseback arrangement (i.e. following the existing treatment as provided in the IRO);
- (d) ensuring that qualifying ship lessors and qualifying ship leasing managers conduct business transactions with their associated parties on an arm's length basis;
- (e) introducing main purpose tests to prevent tax avoidance and treaty shopping; and
- (f) reducing the tax deduction for payments made by a lessee to its connected qualifying ship lessor by an amount of tax saving obtained by the lessor to maintain tax symmetry and prevent revenue loss.

Compliance with international standards

15. In determining whether a preferential tax regime meets the international standards on counteracting BEPS, the OECD will take into account whether the regime can meet the substantial activity requirements to ensure that only those entities which undertake core income generating activities in a jurisdiction would benefit from the regime. The substantial activity requirements involve two conditions in Hong Kong, namely (a) an adequate number of the full-time qualified employees and (b) an adequate amount of operating expenditure. After industry consultation, the minimum thresholds for the above two measurements for the ship leasing and ship leasing management tax regimes are proposed as follows (measured at the group company level) –

<u>Qualifying activity</u>	<u>Number of full-time qualified employees</u>	<u>Annual operating expenditure</u>
Ship leasing	2	HK\$7.8 million (equivalent to US\$1 million)
Ship leasing management	1	HK\$1 million

16. The thresholds are proposed with the advice of the trade by reference to the actual operating statistics of ship leasing and ship leasing management companies. Given that the referenced companies are genuinely carrying out substantive businesses, while the proposed tax regime for qualifying ship leasing and ship leasing management activities is subject to the OECD's scrutiny, we are optimistic that the proposal featuring substantial activity requirements and without ringfencing from the domestic economy¹, would not be labelled by OECD as a harmful tax practice for the purposes of anti-BEPS measures.

Potential benefits of the proposal

17. According to the analysis conducted by the Task Force on Ship Leasing ("the Task Force") under the Hong Kong Maritime and Port Board, with relevant input from experts in the shipping and ship finance industries, if the proposed new tax regime for ship leasing is put in place, it is estimated that Hong Kong could capture 12% of the global ship finance market in ten years' time. This would bring about the following potential benefits (in 2018 dollars) –

- (a) cumulative incremental ship finance business of about HK\$265 billion to HK\$460 billion over 10 years compared to the case if no tax measure is introduced;
- (b) cumulative value added of around HK\$20 billion to HK\$35 billion over 10 years (from HK\$0.4 billion to HK\$0.6 billion in Year 1 to HK\$3.6 billion to HK\$6.3 billion in Year 10);
- (c) direct employment of around 6 400 to 11 200 jobs (in terms of man-years) over 10 years (from 120 to 200 jobs in Year 1 to 1 170 to 2 040 jobs in Year 10); and
- (d) indirect employment of about 23 000 to 40 000 jobs (in terms of

¹ For the purpose of considering whether a tax regime constitutes a harmful tax practice, the OECD would consider various factors including the ringfencing issue. A preferential regime will be considered to be ringfenced from the domestic economy if (i) it excludes resident taxpayers from the benefits of the regime or (ii) an enterprise qualifying for the regime does not have access to the domestic market.

man-years) in the economic sectors/activities in support of the ship leasing business/activities over 10 years due to the linkage effects.

THE BILL

18. The Bill provides for the profits tax concessions for qualifying ship lessors and qualifying ship leasing managers, makes provisions for profits tax purposes about businesses in connection with ships, and makes related amendments to the IRO. The main provisions of the Bill are as follows –

- (a) **Clauses 5, 18 and 19** add the new sections 14O to 14ZB and the new Schedules 8C and 17FA to the IRO to –
 - (i) provide for the interpretation of terms, including “qualifying ship leasing activity” and “qualifying ship leasing management activity” for the proposed tax concessions provisions (the new section 14O and section 1 of the new Schedule 17FA);
 - (ii) provide for profits tax concessions to qualifying ship lessors and qualifying ship leasing managers, the calculation of net lease payments for operating leases and net payments of finance charges or interests for funding leases, and certain tax treatments (the new sections 14P, 14Q, 14R, 14S and 14T and the new Schedule 8C);
 - (iii) provide for the safe harbour rule for the qualification as a qualifying ship leasing manager (the new section 14U);
 - (iv) provide for CIR’s power to determine that a corporation is a qualifying ship leasing manager (the new section 14V);
 - (v) provide for substantial activity threshold requirements, treatment of certain losses, anti-avoidance provisions and CIR’s power to amend the new Schedule 17FA (the new sections 14W, 14X, 14Y, 14Z, 14ZA and 14ZB and the new Schedule 17FA);
- (b) **Clause 6** amends section 15 of the IRO to deem sums received by or accrued to a corporation from carrying on certain businesses in connection with ships as having a Hong Kong source, even if the ships are used outside Hong Kong;
- (c) **Clause 8** amends consequentially section 16 of the IRO and adds

a new section 16(3D) to deem the payments of finance charges or interests for the right to use the ship under a funding lease as sums payable by way of interest on money borrowed for the purpose of producing the profits;

- (d) **Clause 9** amends consequentially section 19CA of the IRO to provide for adjustments in respect of relevant losses to be set off against the concessionary trading receipt chargeable to tax under the new section 14P or 14T;
- (e) **Clauses 10, 11, 12 and 13** amend sections 37, 38, 39B and 39D of the IRO respectively to deal with computation of the cost and capital expenditure in relation to a ship that is used by a corporation for carrying out a qualifying ship leasing activity before being used in another trade, profession or business;
- (f) **Clauses 15 and 20** add a new Schedule to the IRO to deal with transitional matters; and
- (g) **Clauses 4, 14, 16 and 17** are consequential amendments to sections 14, 63H and 100 of, and Schedule 8 to, the IRO respectively.

LEGISLATIVE TIMETABLE

19. The legislative timetable is as follows –

Publication in the Gazette	17 January 2020
First Reading and commencement of Second Reading debate	12 February 2020
Resumption of Second Reading debate, Committee Stage and Third Reading	To be notified

IMPLICATIONS OF THE PROPOSAL

20. The Bill is in conformity with the Basic Law, including the provisions concerning human rights. It will not affect the current binding effect of the IRO. It has no civil service, competition, environmental, family, gender or productivity implications. The financial, economic and sustainability implications of the proposal are set out at **Annex B**.

PUBLIC CONSULTATION

21. The proposed dedicated tax regime for the ship leasing business was developed by the Task Force, where tax, financial, legal and maritime experts as well as relevant Government bureaux/departments (i.e. Transport and Housing Bureau, Financial Secretary Office's Tax Policy Unit, and Inland Revenue Department) are represented.

22. We consulted individual industry stakeholders on the Task Force's proposal during July to August 2019 and they expressed support for the proposal. The proposal was also presented to the Hong Kong Maritime and Port Board and the Hong Kong Shipowners Association in early September and early November 2019 respectively. Industry stakeholders supported the proposal and opined that the introduction of tax concession would be conducive to enhancing Hong Kong's attractiveness as a base for the ship leasing business. We consulted the LegCo Economic Development Panel on the proposed tax regime on 26 November 2019. Members showed general support and urged the Administration to expedite work with a view to enacting the legislative proposals as soon as possible.

23. We have also established initial contact with some ship leasing companies. These companies indicated that they would actively consider setting up businesses in Hong Kong should there be a competitive tax regime. They considered that the measure would help them expand their businesses in the region more effectively riding on our strategic location and range of professional business services.

PUBLICITY

24. We will issue a press release upon gazettal of the Bill, and arrange a spokesperson to answer media enquiries.

ENQUIRIES

25. Enquiries may be directed to Miss Vicky Cheung, Principal Assistant Secretary for Transport and Housing (Transport), at 3509 8154.

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A BILL

To

Amend the Inland Revenue Ordinance to give profits tax concessions to qualifying ship lessors and qualifying ship leasing managers; to make provisions for profits tax purposes about businesses in connection with ships; and to make related amendments.

Enacted by the Legislative Council.

1. Short title

This Ordinance may be cited as the Inland Revenue (Amendment) (Ship Leasing Tax Concessions) Ordinance 2020.

2. Inland Revenue Ordinance amended

The Inland Revenue Ordinance (Cap. 112) is amended as set out in sections 3 to 20.

3. Section 2 amended (interpretation)

(1) Section 2(1), definition of *lease*—

Repeal

“and Schedule 17F”

Substitute

“, the ship leasing tax concessions provisions and Schedules 17F and 17FA”.

(2) Section 2(1)—

Add in alphabetical order

“*ship leasing tax concessions provisions* (船舶租賃稅務寬減條文) means sections 14O, 14P, 14Q, 14R, 14S, 14T, 14U, 14V, 14W, 14X, 14Y, 14Z, 14ZA and 14ZB;”.

4. Section 14 amended (charge of profits tax)

Section 14(5)—

Repeal

“or 14J(5)(b)”

Substitute

“, 14J(5)(b), 14P(4)(b) or 14T(5)(b)”.

5. Sections 14O to 14ZB added

After section 14N—

Add

“14O. Ship leasing tax concessions: interpretation

(1) In the ship leasing tax concessions provisions—

actual residual value (實際剩餘價值), in relation to a ship, means the actual fair market value of the ship at the end of the term of a lease or its useful economic life;

associate (相聯者)—

(a) in relation to a natural person, means—

(i) a relative of the person;

(ii) a partner of the person;

(iii) if a partner of the person is a natural person—
a relative of the partner;

(iv) a partnership in which the person is a partner;

(v) a corporation controlled by—

(A) the person;

- (B) a relative of the person;
- (C) a partner of the person;
- (D) if a partner of the person is a natural person—a relative of the partner; or
- (E) a partnership in which the person is a partner; or
- (vi) a director or principal officer of a corporation mentioned in subparagraph (v);
- (b) in relation to a corporation, means—
 - (i) a person who has control over the corporation;
 - (ii) a partner of a person mentioned in subparagraph (i);
 - (iii) if a person mentioned in subparagraph (i) is a natural person—a relative of the person;
 - (iv) if a partner mentioned in subparagraph (ii) is a natural person—a relative of the partner;
 - (v) a director or principal officer of—
 - (A) the corporation; or
 - (B) an associated corporation of the corporation;
 - (vi) a relative of a director (if the director is a natural person) or principal officer mentioned in subparagraph (v);
 - (vii) a partner of the corporation;
 - (viii) if a partner of the corporation is a natural person—a relative of the partner;
 - (ix) a partnership in which the corporation is a partner; or
 - (x) an associated corporation of the corporation;

- (c) in relation to a partnership, means—
 - (i) a partner in the partnership;
 - (ii) if a partner in the partnership is a natural person—a relative of the partner;
 - (iii) if a partner in the partnership is another partnership—
 - (A) a partner in the other partnership (*Partner A*); or
 - (B) a partner with the other partnership in any other partnership (*Partner B*);
 - (iv) if Partner A is a partnership—a partner in Partner A (*Partner C*);
 - (v) if Partner B is a partnership—a partner in Partner B (*Partner D*);
 - (vi) if Partner A, Partner B, Partner C or Partner D is a natural person—a relative of the partner;
 - (vii) a corporation controlled by—
 - (A) the partnership;
 - (B) a partner in the partnership;
 - (C) if a partner in the partnership is a natural person—a relative of the partner; or
 - (D) a partnership in which the partnership is a partner;
 - (viii) a director or principal officer of a corporation mentioned in subparagraph (vii);
 - (ix) a corporation of which a partner in the partnership is a director or principal officer; or
 - (x) an associated partnership of the partnership;

associated corporation (相聯法團), in relation to a corporation, means—

- (a) another corporation over which the corporation has control;
- (b) another corporation that has control over the corporation; or
- (c) another corporation that is under the control of the same person as is the corporation;

associated partnership (相聯合夥), in relation to a partnership, means—

- (a) another partnership over which the partnership has control;
- (b) another partnership that has control over the partnership; or
- (c) another partnership that is under the control of the same person as is the partnership;

connected person (有關連者), in relation to a corporation, means—

- (a) an associated corporation of the corporation;
- (b) a person (other than a corporation)—
 - (i) over whom the corporation has control;
 - (ii) who has control over the corporation; or
 - (iii) who is under the control of the same person as is the corporation; or
- (c) a partnership in which the corporation or its associate is a partner;

control (控制), in relation to the definitions of *associate*, *associated corporation*, *associated partnership* and *connected person*—see subsection (2);

estimated residual value (估計剩餘價值), in relation to a ship, means an estimated fair market value of the ship at the end of the term of a lease or its useful economic life;

funding lease (融購租約) means an arrangement—

- (a) under which a right to use a ship is granted by a person (*lessor*) to another person (*lessee*) for a term exceeding 1 year;
- (b) that satisfies one of the following conditions at its inception—
 - (i) the arrangement is accounted for as a finance lease or loan by the lessor in accordance with—
 - (A) the Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants, as in force from time to time; or
 - (B) the International Financial Reporting Standards issued by the International Accounting Standards Board, as in force from time to time;
 - (ii) the present value of the aggregate minimum lease payments (whether or not they are periodic payments and including any sum payable under a residual value guarantee) during the term of the arrangement is equal to or more than 80% of the fair market value of the ship;
 - (iii) the term of the arrangement is equal to or more than 65% of the remaining useful economic life of the ship; and

- (c) under which the property in the ship will or may pass to the lessee, or an associate of the lessee, at the end of its term,

and includes an agreement or another arrangement in connection with such an arrangement;

Note—

See also subsection (3).

lease (租約), when used as a noun, means—

- (a) an operating lease; or
(b) a funding lease,

and **lease** (租賃), when used as a verb, is to be construed accordingly;

operating lease (營運租約)—

- (a) means—
- (i) an arrangement under which a right to use a ship is granted by an owner of the ship to another person for a term exceeding 1 year (*specified head lease*); or
 - (ii) an arrangement under which a right to use a ship is granted by a lessee under a specified head lease (or by a sub-lessee or any other person deriving the right under the lessee) to another person; and

- (b) does not include a funding lease;

own (擁有) includes—

- (a) to hold as a lessee under a funding lease;
(b) to hold as a bailee under a hire-purchase agreement; and

- (c) to hold as a buyer under a conditional sale agreement;

Note—

See also subsection (4).

permanent establishment (常設機構)—

- (a) means a branch, management or other place of business; but
(b) does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of a principal;

principal officer (主要職員), in relation to a corporation, means—

- (a) a person employed by the corporation who, either alone or jointly with one or more other persons, is responsible under the immediate authority of the directors of the corporation for the conduct of the business of the corporation; or
(b) a person employed by the corporation who, under the immediate authority of a director of the corporation or a person to whom paragraph (a) applies, exercises managerial functions in respect of the corporation;

qualifying ship leasing activity (合資格船舶租賃活動)—see subsection (5);

qualifying ship leasing management activity (合資格船舶租賃管理活動)—see subsection (7);

qualifying ship leasing manager (合資格船舶租賃管理商)—see section 14T(2);

qualifying ship lessor (合資格船舶出租商)—see section 14P(2);

relative (親屬), in relation to a person, means the spouse, parent, child, brother or sister of the person, and, in deducing such a relationship—

- (a) an adopted child is to be regarded as a child of both the natural parents and any adopting parent; and
- (b) a step child is to be regarded as a child of both the natural parents and any step parent;

residual value guarantee (剩餘價值擔保), in relation to a ship, means a financial commitment to pay a sum by reference to the amount by which the estimated residual value of the ship exceeds the actual residual value of the ship;

ship (船舶) means a vessel of any description capable of navigating in water and—

- (a) includes—
 - (i) a barge or lighter;
 - (ii) an air-cushion vehicle; and
 - (iii) a dynamically supported craft as defined by section 2 of the Shipping and Port Control Ordinance (Cap. 313); and
- (b) does not include—
 - (i) a junk as defined by section 2 of the Merchant Shipping Ordinance (Cap. 281);
 - (ii) a vessel propelled by oars; or
 - (iii) a vessel solely for military use;

ship leasing activity (船舶租賃活動)—see section 1(1) of Schedule 17FA;

ship leasing management activity (船舶租賃管理活動)—see section 1(1) of Schedule 17FA;

ship leasing management asset (船舶租賃管理資產), in relation to a corporation, means an asset of the corporation used by it to carry out a qualifying ship leasing management activity;

ship leasing management profits (船舶租賃管理利潤), in relation to a corporation, means any profits of the corporation that are derived from a qualifying ship leasing management activity;

ship leasing manager (船舶租賃管理商) means a person carrying on a business of carrying out ship leasing management activities;

ship lessor (船舶出租商) means a person carrying on a business of carrying out ship leasing activities;

ship operation business (船舶營運業務)—

- (a) means a business of operating ships as an owner or a charterer for providing services for the carriage by ships of passengers, cargo or mail; but
- (b) does not include dealing in ships or agency business in connection with sea transport;

ship operator (船舶營運商) means a person carrying on a ship operation business.

(2) For the purposes of the definitions of *associate*, *associated corporation*, *associated partnership* and *connected person* in subsection (1)—

- (a) a person has control over a corporation if the person has the power to secure—
 - (i) by means of the holding of shares or the possession of voting power in or in relation to that or any other corporation; or

- (ii) by virtue of any powers conferred by the articles of association or other document regulating that or any other corporation, that the affairs of the first-mentioned corporation are conducted in accordance with the wishes of that person;
- (b) a person has control over a partnership if the person has the power to secure—
- (i) by means of the holding of interests or the possession of voting power in or in relation to that or any other partnership; or
- (ii) by virtue of any powers conferred by the partnership agreement or other document regulating that or any other partnership, that the affairs of the first-mentioned partnership are conducted in accordance with the wishes of that person; and
- (c) a person (*first-mentioned person*) has control over another person who is a natural person (*second-mentioned person*) if the second-mentioned person is accustomed or under an obligation (whether express or implied, and whether or not enforceable or intended to be enforceable by legal proceedings) to act, in relation to the investment or business affairs of the second-mentioned person, in accordance with the directions, instructions or wishes of the first-mentioned person.
- (3) For the purposes of the definition of *funding lease* in subsection (1), an arrangement does not fall within paragraph (c) of the definition if, in the opinion of the Commissioner, the property in the ship concerned would reasonably be expected not to pass to the lessee, or an

- associate of the lessee, under the arrangement at the end of its term.
- (4) In the definition of *own* in subsection (1), a reference to a hire-purchase agreement or conditional sale agreement does not include one under which, in the opinion of the Commissioner, the property in the ship concerned would reasonably be expected not to pass to the bailee or buyer (as the case may be).
- (5) A ship leasing activity carried out by a corporation in respect of a ship is a qualifying ship leasing activity if—
- (a) the activity is carried out in the ordinary course of the corporation's business carried on in Hong Kong; and
- (b) the ship is—
- (i) of over 500 gross tonnage; and
- (ii) navigating solely or mainly outside the waters of Hong Kong.
- (6) For the purposes of subsection (5)(b)(i), a ship's gross tonnage is determined in accordance with the formula set out in regulation 6 of the Merchant Shipping (Registration) (Tonnage) Regulations (Cap. 415 sub. leg. C).
- (7) A ship leasing management activity carried out by a corporation in respect of a ship is a qualifying ship leasing management activity if—
- (a) the activity is carried out in the ordinary course of the corporation's business carried on in Hong Kong;
- (b) the activity is carried out for another corporation during the basis period of the other corporation for a year of assessment;

- (c) the other corporation is a qualifying ship lessor for that year of assessment; and
 - (d) the ship is leased by the other corporation to a ship lessor, ship leasing manager or ship operator when the activity is carried out.
- (8) A note located in the text of the ship leasing tax concessions provisions is provided for information only and has no legislative effect.

14P. Ship leasing tax concessions: concession for qualifying ship lessor

- (1) For the purposes of this Part and subject to subsections (4) and (6), the assessable profits of a corporation that is a qualifying ship lessor for a year of assessment are chargeable to tax under this Part at the rate specified in Schedule 8C to the extent to which those profits are assessable profits derived from its qualifying ship leasing activity.
- (2) A ship lessor is a qualifying ship lessor for a year of assessment if, during the basis period for that year of assessment—
- (a) it is not a ship operator;
 - (b) it has carried out in Hong Kong one or more qualifying ship leasing activities; and
 - (c) it has not carried out in Hong Kong any activity other than a qualifying ship leasing activity.
- (3) For the purposes of subsection (2)(c), in determining whether a ship lessor has carried out any activity other than a qualifying ship leasing activity, only activities that generate income to the ship lessor are to be taken into account.

- (4) Subsection (1) applies to a corporation for a year of assessment only if—
- (a) during the basis period for that year of assessment—
 - (i) the central management and control of the corporation is exercised in Hong Kong;
 - (ii) the activities that produce its qualifying profits for that year are—
 - (A) carried out in Hong Kong by the corporation; or
 - (B) arranged by the corporation to be carried out in Hong Kong; and
 - (iii) those activities are not carried out by a permanent establishment outside Hong Kong; and
 - (b) the corporation has elected in writing that subsection (1) applies to it.
- Note—**
See also section 14W.
- (5) An election under subsection (4)(b), once made, is irrevocable.
- (6) If subsection (1) does not apply to a corporation for a year of assessment (*cessation year*) while it did for the previous year of assessment—
- (a) the election made by the corporation under subsection (4)(b) ceases to be effective; and
 - (b) despite anything in this section, subsection (1) is not to apply to the corporation for the year of assessment that follows the cessation year.
- (7) A ship owned by a corporation is to be treated as a capital asset of the corporation for the purposes of this Part if—

- (a) the corporation uses the ship for carrying out a qualifying ship leasing activity for a continuous period of not less than 3 years immediately before it disposes of the ship; and
- (b) subsection (1) applies in relation to that activity for any year of assessment.

(8) In this section—

qualifying profits (合資格利潤), in relation to a corporation, means the assessable profits of the corporation that fall within subsection (1).

14Q. Ship leasing tax concessions: allowance for capital expenditure on ship

- (1) If section 14P(1) applies to a corporation for a year of assessment, the corporation is not entitled to be granted any allowance under Part 6 for that year of assessment in respect of the capital expenditure incurred on the provision of the ship concerned.
- (2) If—
 - (a) a person (*initial transferor*), whether alone or with others and whether directly or through an interposed person, transfers a ship by way of sale to a corporation (*initial transferee*);
 - (b) the initial transferee subsequently leases the ship to the initial transferor, or to an associate of the initial transferor, under a funding lease (*leaseback activity*); and
 - (c) the leaseback activity is a qualifying ship leasing activity, and the initial transferee is a qualifying ship lessor for a year of assessment by virtue of carrying out the activity,

for the purposes of Part 6, the transfer is not treated as a sale of the ship concerned.

14R. Ship leasing tax concessions: calculation of net lease payments for operating leases

- (1) If section 14P(1) applies to a corporation for a year of assessment, and the qualifying ship leasing activity concerned relates to an operating lease, then the assessable profits of the corporation derived from the activity for that year of assessment are calculated in accordance with this section.
- (2) Unless subsection (3) applies, the net lease payments for the right to use a ship under the operating lease are to be calculated in accordance with the following formula—

$$A = (B - C) \times D$$

where: A means the net lease payments;

B means the aggregate amount of the gross lease payments (whether or not they are periodic payments and including any sum payable under a residual value guarantee) earned by or accrued to the corporation under the operating lease during the basis period for the year of assessment;

C means the aggregate amount of any outgoings and expenses deductible under this Part to the extent to which they are incurred during the basis period for the year of assessment by the corporation in the production of those gross lease payments; and

D means the percentage prescribed in section 2 of Schedule 17FA.

- (3) If there are special circumstances in relation to a year of assessment, the net lease payments for the right to use a ship under the operating lease are to be calculated in accordance with the following formula—

$$A = B - C$$

where: A means the net lease payments;

B means the aggregate amount of the gross lease payments (whether or not they are periodic payments and including any sum payable under a residual value guarantee) earned by or accrued to the corporation under the operating lease during the basis period for the year of assessment; and

C means the aggregate amount of any outgoings and expenses deductible under this Part to the extent to which they are incurred during the basis period for the year of assessment by the corporation in the production of those gross lease payments.

- (4) For the purposes of subsection (3), there are special circumstances in relation to a year of assessment if, in relation to the year—
- (a) the corporation carries out the qualifying ship leasing activity other than as an owner of the ship concerned;
 - (b) the corporation has not incurred capital expenditure on the provision of the ship concerned;
 - (c) allowances under Part 6 have been granted to the corporation or a connected person of the corporation

in respect of the capital expenditure incurred on the provision of the ship concerned;

- (d) capital allowances are granted to a connected person of the corporation, whether in Hong Kong or in a territory outside Hong Kong, for the year of assessment in respect of the capital expenditure incurred on the provision of the ship concerned; or
 - (e) the corporation carries out the qualifying ship leasing activity as an owner of the ship concerned, and the ship was, before the acquisition of the ship by the corporation—
 - (i) owned and used by the lessee (whether alone or with others); or
 - (ii) owned and used by an associate of the lessee.
- (5) However, subsection (4)(e) does not apply if—
- (a) the ship concerned was acquired by the corporation from the lessee, or the associate of the lessee, mentioned in that subsection (*end-user*) with a consideration not more than the consideration paid by the end-user to another person (*supplier*) for acquiring the ship from the supplier; and
 - (b) no initial or annual allowances under Part 6 have been granted to the end-user in respect of the ship before the acquisition of the ship by the corporation.
- (6) For the purposes of subsection (5)(b), an allowance is to be regarded as not having been granted if the end-user disclaims the allowance by giving the Commissioner a written notice within—
- (a) 3 months of the date on which the capital expenditure giving rise to the allowance is incurred; or

- (b) any further time that the Commissioner permits in a particular case.
- (7) If a ship is leased under the operating lease together with other dealings in pursuance of one bargain, then for calculating the net lease payments under subsection (2) or (3), the Commissioner must, having regard to all the circumstances of the bargain, allocate an amount of gross lease payments for the right to use the ship under the lease.
- (8) The outgoings and expenses taken into account in calculating the net lease payments under this section may not otherwise be claimed for deduction under this Part.
- (9) In this section—
- acquisition* (取得) means acquisition by a person as owner and includes holding or hiring under a hire-purchase agreement or, if the hire-purchase agreement is a conditional sale agreement, holding as purchaser;
- lessee* (承租人) means the lessee under the operating lease concerned.

14S. Ship leasing tax concessions: calculation of net payments of finance charges or interest for funding leases

- (1) If section 14P(1) applies to a corporation for a year of assessment, and the qualifying ship leasing activity concerned relates to a funding lease, then the assessable profits of the corporation derived from the activity for that year of assessment are calculated in accordance with this section.
- (2) The net payments of finance charges or interest in relation to the right to use a ship under the funding lease are to be calculated in accordance with the following formula—

$$E = F - G$$

where: E means the net payments of finance charges or interest;

F means the aggregate amount of the gross payments of finance charges or interest (whether or not they are periodic payments) earned by or accrued to the corporation under the funding lease during the basis period for the year of assessment; and

G means the aggregate amount of any outgoings and expenses deductible under this Part to the extent to which they are incurred during the basis period for the year of assessment by the corporation in the production of those gross payments of finance charges or interest.

- (3) If a ship is leased under the funding lease together with other dealings in pursuance of one bargain, then for calculating the net payments of finance charges or interest under subsection (2), the Commissioner must, having regard to all the circumstances of the bargain, allocate an amount of gross payments of finance charges or interest in relation to the right to use the ship under the lease.
- (4) The outgoings and expenses taken into account in calculating the net payments of finance charges or interest under this section may not otherwise be claimed for deduction under this Part.

14T. Ship leasing tax concessions: concession for qualifying ship leasing manager

- (1) For the purposes of this Part and subject to subsections (5) and (7), the assessable profits of a corporation that is a

- qualifying ship leasing manager for a year of assessment are chargeable to tax under this Part at—
- (a) to the extent to which those profits are assessable profits derived from its qualifying ship leasing management activity carried out other than for an associated corporation—one-half of the rate specified in Schedule 8; or
 - (b) to the extent to which those profits are assessable profits derived from its qualifying ship leasing management activity carried out for an associated corporation—the rate specified in Schedule 8C.
- (2) A ship leasing manager is a qualifying ship leasing manager for a year of assessment if—
- (a) during the basis period for that year of assessment, it is not a ship operator; and
 - (b) for that year of assessment—
 - (i) it satisfies the conditions specified in subsection (3);
 - (ii) it satisfies the safe harbour rule under section 14U; or
 - (iii) it has obtained the Commissioner's determination under section 14V(1).
- (3) For the purposes of subsection (2)(b)(i), the conditions are that, during the basis period for the year of assessment, the ship leasing manager—
- (a) has carried out in Hong Kong one or more qualifying ship leasing management activities; and
 - (b) has not carried out in Hong Kong any activity other than a qualifying ship leasing management activity.

- (4) For the purposes of subsection (3)(b), in determining whether a ship leasing manager has carried out any activity other than a qualifying ship leasing management activity, only activities that generate income to the ship leasing manager are to be taken into account.
- (5) Subsection (1) applies to a corporation for a year of assessment only if—
 - (a) during the basis period for that year of assessment—
 - (i) the central management and control of the corporation is exercised in Hong Kong;
 - (ii) the activities that produce its qualifying profits for that year are—
 - (A) carried out in Hong Kong by the corporation; or
 - (B) arranged by the corporation to be carried out in Hong Kong; and
 - (iii) those activities are not carried out by a permanent establishment outside Hong Kong; and
 - (b) the corporation has elected in writing that subsection (1) applies to it.

Note—

See also section 14W.

- (6) An election under subsection (5)(b), once made, is irrevocable.
- (7) If subsection (1) does not apply to a corporation for a year of assessment (*cessation year*) while it did for the previous year of assessment—
 - (a) the election made by the corporation under subsection (5)(b) ceases to be effective; and

- (b) despite anything in this section, subsection (1) is not to apply to the corporation for the year of assessment that follows the cessation year.
- (8) In this section—
qualifying profits (合資格利潤), in relation to a corporation, means the assessable profits of the corporation that fall within subsection (1).
- 14U. Ship leasing tax concessions: safe harbour rule**
- (1) For the purposes of section 14T(2)(b)(ii), a corporation satisfies the safe harbour rule for a year of assessment (*subject year*) if the corporation falls within—
- (a) the 1-year safe harbour under subsection (2); or
- (b) the multiple-year safe harbour under subsection (3).
- (2) A corporation falls within the 1-year safe harbour if, for the subject year—
- (a) its SLMP percentage is not lower than the profits percentage prescribed in section 3 of Schedule 17FA; and
- (b) its SLMA percentage is not lower than the asset percentage prescribed in section 4 of that Schedule.
- (3) A corporation falls within the multiple-year safe harbour if, for the specified years—
- (a) its average SLMP percentage is not lower than the profits percentage prescribed in section 3 of Schedule 17FA; and
- (b) its average SLMA percentage is not lower than the asset percentage prescribed in section 4 of that Schedule.

- (4) In this section, a reference to the specified years for a corporation is a reference to—
- (a) if the corporation has carried on a trade, profession or business in Hong Kong for less than 2 consecutive years of assessment immediately before the subject year—the subject year and the preceding year of assessment (*the 2 years*); or
- (b) if the corporation has carried on a trade, profession or business in Hong Kong for 2 or more consecutive years of assessment immediately before the subject year—the subject year and the preceding 2 years of assessment (*the 3 years*).
- (5) The SLMP percentage of a corporation for a year of assessment is calculated in accordance with the following formula—
- $$\frac{\text{SLMP}}{\text{P}}$$
- where: SLMP means the aggregate amount of the ship leasing management profits of the corporation during the basis period for the year of assessment; and
- P means the aggregate amount of profits accruing to the corporation from all sources, whether in Hong Kong or not, during the basis period for the year of assessment.
- (6) The SLMA percentage of a corporation for a year of assessment is calculated in accordance with the following formula—

SLMA

A

where: SLMA means the aggregate value of the ship leasing management assets of the corporation as at the end of the basis period for the year of assessment; and

A means the aggregate value of all assets, whether in Hong Kong or not, of the corporation as at the end of the basis period for the year of assessment.

- (7) For the purposes of subsection (6), in computing the aggregate value of the ship leasing management assets of a corporation, if a ship leasing management asset is used partly to carry out a qualifying ship leasing management activity and partly for another purpose, only the part of the value of the asset that is proportionate to the extent to which the asset is used to carry out a qualifying ship leasing management activity is to be taken into account.
- (8) A reference to the average SLMP percentage of a corporation for the specified years is a reference to the percentage arrived at by—
 - (a) if subsection (4)(a) applies—dividing the sum of the SLMP percentages of the corporation for the 2 years by 2; or
 - (b) if subsection (4)(b) applies—dividing the sum of the SLMP percentages of the corporation for the 3 years by 3.
- (9) A reference to the average SLMA percentage of a corporation for the specified years is a reference to the percentage arrived at by—

- (a) if subsection (4)(a) applies—dividing the sum of the SLMA percentages of the corporation for the 2 years by 2; or
- (b) if subsection (4)(b) applies—dividing the sum of the SLMA percentages of the corporation for the 3 years by 3.

14V. Ship leasing tax concessions: Commissioner's determination

- (1) For the purposes of section 14T(2)(b)(iii), the Commissioner may, on application by a corporation, determine that the corporation is a qualifying ship leasing manager for a year of assessment.
- (2) A corporation may apply for the Commissioner's determination under subsection (1) only if—
 - (a) it is not a ship operator; and
 - (b) for the year of assessment, it satisfies neither of the following—
 - (i) the conditions specified in section 14T(3);
 - (ii) the safe harbour rule under section 14U.
- (3) The Commissioner may make a determination under subsection (1) only if the Commissioner is of the opinion that the conditions specified in section 14T(3), or the safe harbour rule under section 14U, would, in the ordinary course of business of the corporation, have been satisfied for the year of assessment.

14W. Ship leasing tax concessions: carrying out of activities in Hong Kong

- (1) For the purposes of section 14P(4)(a)(ii), an activity producing the assessable profits of a corporation that fall

within section 14P(1) for a year of assessment is not considered to be carried out in Hong Kong by the corporation or arranged by the corporation to be carried out in Hong Kong during the basis period for that year of assessment unless the threshold requirements are met.

- (2) For the purposes of section 14T(5)(a)(ii), an activity producing the assessable profits of a corporation that fall within section 14T(1) for a year of assessment is not considered to be carried out in Hong Kong by the corporation or arranged by the corporation to be carried out in Hong Kong during the basis period for that year of assessment unless the threshold requirements are met.
- (3) To avoid doubt, the fact that the threshold requirements are not met for the purposes of subsection (1) or (2) does not imply that the assessable profits mentioned in that subsection do not arise in or are not derived from Hong Kong.

- (4) In this section—

threshold requirements (門檻要求) means—

- (a) for the purposes of subsection (1)—the requirements prescribed in section 5 of Schedule 17FA; or
- (b) for the purposes of subsection (2)—the requirements prescribed in section 6 of that Schedule.

14X. Ship leasing tax concessions: losses sustained by qualifying ship lessor or qualifying ship leasing manager

- (1) If section 14P(1) applies to a corporation for a zero-tax year of assessment, any loss sustained by the corporation in the year of assessment is not available for set off against

any of its assessable profits for any subsequent year of assessment.

- (2) If section 14T(1)(b) applies to a corporation for a zero-tax year of assessment, any loss sustained by the corporation in the year of assessment is not available for set off against any of its assessable profits for the year of assessment or any subsequent year of assessment.
- (3) In this section—

zero-tax year of assessment (零稅率課稅年度) means a year of assessment for which the rate of profits tax specified in Schedule 8C is 0%.

14Y. Ship leasing tax concessions: anti-avoidance provisions relating to arm's length principle

- (1) Subsection (2) applies if—
- (a) conditions are made or imposed between a corporation that is a qualifying ship lessor and a person who is an associate of that corporation, in their commercial or financial relations in connection with a qualifying ship leasing activity; and
- (b) the conditions differ from those that would be made if the person were not such an associate.
- (2) Any profits that, but for the conditions referred to in subsection (1)(a), would have accrued to the corporation or the person and, by reason of those conditions, have not so accrued, are to be included in the profits of the corporation or the person and taxed in accordance with this Part.
- (3) Subsection (4) applies if—
- (a) conditions are made or imposed between a corporation that is a qualifying ship leasing manager

- and a person who is an associate of that corporation, in their commercial or financial relations in connection with a qualifying ship leasing management activity; and
- (b) the conditions differ from those that would be made if the person were not such an associate.
- (4) Any profits that, but for the conditions referred to in subsection (3)(a), would have accrued to the corporation or the person and, by reason of those conditions, have not so accrued, are to be included in the profits of the corporation or the person and taxed in accordance with this Part.

14Z. Ship leasing tax concessions: anti-avoidance provisions relating to release of ownership obligation

If—

- (a) a ship is owned by a corporation that is a qualifying ship lessor under an arrangement (*ownership arrangement*); and
- (b) the corporation enters into an arrangement (*release arrangement*) under which—
- (i) it is released from the primary obligation under the ownership arrangement; and
- (ii) that obligation is assumed by another person,

the ship leasing tax concessions provisions are to have effect as if the corporation had ceased to own the ship during the time when the release arrangement is in force.

14ZA. Ship leasing tax concessions: anti-avoidance provisions relating to arrangement to obtain tax benefit

- (1) If—

- (a) a corporation that is a qualifying ship lessor or qualifying ship leasing manager enters into an arrangement; and
- (b) the Commissioner is satisfied that the main purpose, or one of the main purposes, of the corporation in entering into the arrangement is to obtain a tax benefit, whether for the corporation or another person, in relation to a liability to pay profits tax under this Ordinance,

sections 14P(1) and 14T(1) do not apply in relation to any assessable profits accrued to the corporation during a basis period relevant to the arrangement.

- (2) If—

- (a) a corporation that is a qualifying ship lessor enters into an arrangement; and
- (b) the Commissioner is satisfied that the main purpose, or one of the main purposes, of the corporation in entering into the arrangement is to obtain a tax benefit, whether for the corporation or another person, under a tax treaty that is contrary to the purpose of the treaty,

section 14P(1) does not apply in relation to any assessable profits accrued to the corporation during a basis period relevant to the arrangement.

- (3) For the purposes of this section, the basis period of a year of assessment is relevant to an arrangement if, in the opinion of the Commissioner, the arrangement has effect during that basis period.

- (4) In this section—

tax benefit (稅務利益) means an avoidance, postponement or reduction of a liability to pay tax;

tax treaty (稅收協定) means an arrangement made between 2 or more jurisdictions (whether including Hong Kong or otherwise) with a view to affording relief from double taxation.

14ZB. Ship leasing tax concessions: power to amend Schedule 17FA

The Commissioner may by order published in the Gazette amend Schedule 17FA.”.

6. Section 15 amended (certain amounts deemed trading receipts)

(1) Section 15(1)(m)—

Repeal

“and”.

(2) Section 15(1)(n)(ii)—

Repeal

“Kong.”

Substitute

“Kong; and”.

(3) After section 15(1)(n)—

Add

“(o) sums, not otherwise chargeable to tax under this Part, received by or accrued to a corporation by way of gains or profits (other than those arising from the sale of capital assets) arising through or from the carrying on in Hong Kong by the corporation of—

(i) its business of granting a right to use a ship to another person (*ship business*), even if the ship is used outside Hong Kong; or

(ii) its business of managing a corporation carrying on a ship business or of managing a ship business, even if the ship concerned is used outside Hong Kong.”.

(4) After section 15(1D)—

Add

“(1E) For the purposes of subsection (1)(o)(i), if the ship business is a business of granting a right to use a ship under a funding lease as defined by section 14O(1), the finance charges or interest received by or accrued to the corporation for the grant of the right to use the ship are to be regarded as sums received by or accrued to the corporation by way of gains or profits.”.

7. Section 15G added

After section 15F—

Add

“15G. Sums derived from funding leases of ships

To avoid doubt, for the purposes of this Part, if a person is engaged in a business of granting a right to use a ship under a funding lease as defined by section 14O(1), the finance charges or interest received by or accrued to the person for the grant of the right to use the ship are to be regarded as sums received by or accrued to the person by way of interest on money lent by the person.”.

8. Section 16 amended (ascertainment of chargeable profits)

(1) After section 16(1)—

Add

“Note—

See also subsection (3D).”.

- (2) Section 16(1A)(c), (1B) and (1D)—

Repeal

“or 14J(1)”

Substitute

“, 14J(1), 14P(1) or 14T(1)”.

- (3) After section 16(3C)—

Add

“(3D) To avoid doubt, if a person is, in the production of profits, granted a right to use a ship under a funding lease as defined by section 14O(1)—

(a) for the purposes of subsection (1)(a), the payments of finance charges or interest by the person for the right to use the ship are to be regarded as sums payable by the person by way of interest on money borrowed by the person (*specified loan*) for the purpose of producing the profits; and

(b) for the purposes of subsection (2)(e)(i)(A), the specified loan is to be regarded as money borrowed wholly and exclusively to finance capital expenditure incurred by the person on the provision of the ship.

(3E) To avoid doubt, a reference to a reduced tax rate in this section includes a tax rate of 0%.”.

9. **Section 19CA amended (treatment of losses: concessionary trading receipts)**

- (1) Section 19CA(5), definition of *chargeable concessionary trading receipts*, paragraph (a), after “section 14B”—

Add

“or 14P”.

- (2) Section 19CA(5), definition of *chargeable concessionary trading receipts*, paragraph (b)—

Repeal

“(2A);”

Substitute

“(2A); or”.

- (3) Section 19CA(5), at the end of the definition of *chargeable concessionary trading receipts*—

Add

“(d) where the concessionary trading receipts are of a kind in respect of which assessable profits are chargeable to tax at the rate specified in section 14P, the amount of the assessable profits calculated in accordance with section 14R or 14S;”.

- (4) Section 19CA(5), definition of *concession provision*, after paragraph (e)—

Add

“(f) section 14P;

(g) section 14T;”.

- (5) Section 19CA(5), definition of *unabsorbed loss in respect of the concessionary trading receipts*, paragraph (a), after “section 14B”—

Add

“or 14P”.

- (6) Section 19CA(5), definition of *unabsorbed loss in respect of the concessionary trading receipts*, paragraph (b)—

Repeal

“(2A);”

Substitute

“(2A); or”.

- (7) Section 19CA(5), at the end of the definition of *unabsorbed loss in respect of the concessionary trading receipts*—

Add

“(d) where the concessionary trading receipts are of a kind in respect of which assessable profits are chargeable to tax at the rate specified in section 14P, the loss arrived at in accordance with section 19D and section 14R or 14S;”.

10. **Section 37 amended (initial and annual allowances, machinery or plant)**

After section 37(2D)—

Add

“(2E) Subsection (2F) applies if a ship was owned and used by a corporation for carrying out a qualifying ship leasing activity in respect of which section 14P(1) applies before the corporation uses it in another trade, profession or business to produce profits chargeable to tax under Part 4.

(2F) For the purposes of subsection (2), the cost of the asset, in relation to the ship, is the sum computed by deducting from the actual cost the notional amount of annual allowances that would have been made under that subsection to the corporation if such annual allowances had been available to the corporation since it acquired the ship.

(2G) In subsections (2E) and (2F)—

qualifying ship leasing activity (合資格船舶租賃活動) has the meaning given by section 14O(5);

ship (船舶) has the meaning given by section 14O(1).”.

11. **Section 38 amended (balancing allowances and charges, machinery or plant)**

Section 38(2)—

Repeal

“or (2C)”

Substitute

“, (2C) or (2F)”.

12. **Section 39B amended (initial and annual allowances on machinery or plant under the pooling system)**

(1) Section 39B(4), after “(6B)”—

Add

“, (6E)”.

(2) After section 39B(6C)—

Add

“(6D) Subsection (6E) applies if a ship was owned and used by a corporation for carrying out a qualifying ship leasing activity in respect of which section 14P(1) applies before the corporation uses it in another trade, profession or business to produce profits chargeable to tax under Part 4.

(6E) For the purposes of subsection (4), the capital expenditure incurred on the provision of the ship is to be computed by deducting from the actual cost the notional amount of annual allowances that would have been made under section 37(2) to the corporation if such annual allowances had been available to the corporation since it acquired the ship.

(6F) In subsections (6D) and (6E)—

qualifying ship leasing activity (合資格船舶租賃活動) has the meaning given by section 14O(5);

ship (船隻) has the meaning given by section 14O(1).”.

13. Section 39D amended (balancing allowances and charges under the pooling system)

(1) Section 39D(7)(a)—

Repeal

“or (2C)”

Substitute

“, (2C) or (2F)”.

(2) Section 39D(7)(b)—

Repeal

“or (6B)”

Substitute

“, (6B) or (6E)”.

14. Section 63H amended (amount of provisional profits tax)

Section 63H(1D)—

Repeal

“or 14J(5)(b)”

Substitute

“, 14J(5)(b), 14P(4)(b) or 14T(5)(b)”.

15. Section 89 amended (transitional provisions)

Section 89—

Add

“(26) Schedule 51 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) (Ship Leasing Tax Concessions) Ordinance 2020 (of 2020).”.

16. Section 100 amended (reduction of taxes)

Section 100(2)(a)—

Repeal

“and 14J”

Substitute

“, 14J, 14P and 14T”.

17. Schedule 8 amended (rate of profits tax in respect of a corporation)

Schedule 8, after “14J,”—

Add

“14T,”.

18. Schedule 8C added

After Schedule 8B—

Add

“Schedule 8C

[ss. 14P, 14T & 14X]

Rate of Profits Tax for Qualifying Ship Lessor or Qualifying Ship Leasing Manager

For a year of assessment commencing on or after 1 April 2020 0%”.

19. Schedule 17FA added

After Schedule 17F—

Add

“Schedule 17FA

[ss. 2, 14O, 14R, 14U,
14W & 14ZB]

Ship Leasing Tax Concessions

Part 1

**Ship Leasing Activity and Ship Leasing
Management Activity**

1. Meaning of *ship leasing activity* and *ship leasing management activity*

(1) In this section and the ship leasing tax concessions provisions—

ship leasing activity (船舶租賃活動), in relation to a person, means leasing of a ship by the person to a ship lessor, ship leasing manager or ship operator;

ship leasing management activity (船舶租賃管理活動), in relation to a corporation, means any of the following activities—

- (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.
- (2) In paragraph (1) of the definition of *ship leasing management activity* in subsection (1)—
- contingent purchase arrangement* (待確定購買安排) means an arrangement under which a person is required to purchase a ship at a predetermined amount if the actual residual value falls below the estimated residual value.
- (3) The words and expressions used in this section and defined in section 14O for the purposes of the ship leasing tax concessions provisions have the same meaning as in those provisions.

Part 2

Prescribed Percentage for Calculation of Net Lease Payments

2. **Prescribed percentage for calculation of net lease payments**
For the purposes of section 14R, the prescribed percentage is 20%.

Part 3

Prescribed Percentages for Safe Harbour Rule

3. **Prescribed profits percentage**
For the purposes of section 14U, the prescribed profits percentage is 75%.
4. **Prescribed asset percentage**
For the purposes of section 14U, the prescribed asset percentage is 75%.

Part 4

Threshold Requirements for Section 14W

5. **Qualifying Ship Leasing Activity**
For the purposes of paragraph (a) of the definition of *threshold requirements* in section 14W(4), the requirements are that—
- (a) during the basis period for the year of assessment concerned, the average number of full-time employees in Hong Kong who carry out the activity concerned and have the qualifications necessary for doing so is not less than 2; and
 - (b) the total amount of operating expenditure incurred in Hong Kong for the activity during the basis period for that year of assessment is not less than \$7,800,000.
6. **Qualifying Ship Leasing Management Activity**
For the purposes of paragraph (b) of the definition of *threshold requirements* in section 14W(4), the requirements are that—

- (a) during the basis period for the year of assessment concerned, the average number of full-time employees in Hong Kong who carry out the activity concerned and have the qualifications necessary for doing so is not less than 1; and
- (b) the total amount of operating expenditure incurred in Hong Kong for the activity during the basis period for that year of assessment is not less than \$1,000,000.”.

20. Schedule 51 added

The Ordinance—

Add

“Schedule 51

[s. 89(26)]

**Transitional Provisions for Inland Revenue
(Amendment) (Ship Leasing Tax Concessions)
Ordinance 2020**

- 1. In calculating the qualifying profits in relation to a corporation for the purposes of section 14P(1), sums received by or accrued to the corporation before 1 April 2020 are not to be taken into account.
- 2. In calculating the qualifying profits in relation to a corporation for the purposes of section 14T(1), sums received by or accrued to the corporation before 1 April 2020 are not to be taken into account.

- 3. Section 15(1)(o) does not apply to sums received or accrued before the Inland Revenue (Amendment) (Ship Leasing Tax Concessions) Ordinance 2020 (of 2020) comes into operation.”.

Explanatory Memorandum

The main object of this Bill is to amend the Inland Revenue Ordinance (Cap. 112) (*principal Ordinance*) to give profits tax concessions to corporations carrying on certain businesses in connection with ships and to make provisions for profits tax purposes about such businesses.

2. Clause 5 adds new sections 14O to 14ZB to the principal Ordinance.
3. The new section 14O provides for the interpretation of terms used in the new provisions for the profits tax concessions, including the definitions of *qualifying ship leasing activity* and *qualifying ship leasing management activity*.
4. The new section 14P provides that a corporation that is a qualifying ship lessor for a year of assessment is entitled to have its profits derived from its qualifying ship leasing activity for that year of assessment charged at a concessionary rate specified in the new Schedule 8C to the principal Ordinance (added by clause 18) (new section 14P(1)). That section also provides for how a corporation may be a qualifying ship lessor (new section 14P(2)) and how it can be entitled to the concessionary rate (new section 14P(4)).
5. The new section 14Q provides for certain tax treatments in connection with qualifying ship lessors.
6. The new section 14R provides that if the profits tax concession under the new section 14P applies to a corporation for a year of assessment, the net lease payments for operating leases derived from its qualifying ship leasing activity are to be calculated in accordance with the formula set out in the new section 14R(2) or (3).
7. The new section 14S provides that if the profits tax concession under the new section 14P applies to a corporation for a year of assessment, the net payments of finance charges or interest in relation to funding leases derived from its qualifying ship leasing activity are to be

calculated in accordance with the formula set out in the new section 14S(2).

8. The new section 14T provides that a corporation that is a qualifying ship leasing manager for a year of assessment is entitled to have its profits derived from its qualifying ship leasing management activity for that year of assessment charged at a concessionary rate (new section 14T(1)). The concessionary rate is one-half of the profits tax rate specified in Schedule 8 to the principal Ordinance if the activity is not carried out for an associate corporation, or the profits tax rate specified in the new Schedule 8C to the principal Ordinance if it is. The new section 14T(2) provides for how a corporation may be a qualifying ship leasing manager, namely—
 - (a) by satisfying the conditions specified in the new section 14T(3);
 - (b) by satisfying the safe harbour rule under the new section 14U; or
 - (c) by obtaining the determination of the Commissioner of Inland Revenue (*Commissioner*) under the new section 14V.

The new section 14T(5) provides for certain conditions for the entitlement to the concessionary rate.

9. The new section 14U provides for how a corporation may satisfy the safe harbour rule. There are 2 alternative safe harbours as follows—
 - (a) the “1-year safe harbour” which requires the corporation to satisfy certain conditions regarding its ship leasing management profits and ship leasing management assets for the year of assessment concerned (new section 14U(2));
 - (b) the “multiple-year safe harbour” which requires the corporation to satisfy similar conditions for the year of

- assessment concerned and the preceding 1 or 2 years of assessment (new section 14U(3)).
10. The new section 14V provides for the Commissioner's discretion to make a determination that a corporation, which is not otherwise qualified, is a qualifying ship leasing manager.
 11. The new section 14W provides that, for the purposes of the new sections 14P(4) and 14T(5), certain threshold requirements under the new Schedule 17FA to the principal Ordinance (added by clause 19) must be met in order for a ship leasing activity or ship leasing management activity to be considered to be carried out, or arranged to be carried out, in Hong Kong.
 12. The new section 14X sets out the circumstances under which the losses sustained by a corporation are not available for set off against its assessable profits.
 13. The new sections 14Y, 14Z and 14ZA contain certain provisions for preventing avoidance of profits tax by means of the new profits tax concessions.
 14. The new section 14ZB empowers the Commissioner to amend, by order published in the Gazette, the new Schedule 17FA to the principal Ordinance which—
 - (a) contains the definitions of *ship leasing activity* and *ship leasing management activity*;
 - (b) specifies the prescribed percentages relating to the calculation of net lease payments and the safe harbour rule; and
 - (c) prescribes the threshold requirements for the purposes of the new section 14W.
 15. Clause 6 amends section 15 of the principal Ordinance to add a new section 15(1)(o) and (1E) to deem sums received by or accrued to a corporation from carrying on certain businesses in connection with

- ships as having a Hong Kong source, even if the ships are used outside Hong Kong.
16. Clause 7 adds a new section 15G to the principal Ordinance to provide that receipts of finance charges or interest by a person in relation to a funding lease in the course of business are to be regarded as sums received by or accrued to the person by way of interest on money lent by the person.
 17. Clause 8 consequentially amends section 16 of the principal Ordinance, and adds a new section 16(3D) to provide that payments of finance charges or interest by a person in relation to a funding lease in the production of profits are to be regarded as sums payable by way of interest on money borrowed by the person for the purpose of producing the profits.
 18. Clauses 10, 11, 12 and 13 amend sections 37, 38, 39B and 39D of the principal Ordinance respectively to deal with computation of the cost and capital expenditure in relation to a ship that is used by a corporation for carrying out a qualifying ship leasing activity before being used in another trade, profession or business.
 19. Clause 20 adds a new Schedule 51 to the principal Ordinance to deal with transitional matters.
 20. Clauses 4, 9, 14, 16 and 17 consequentially amend the following provisions of the principal Ordinance respectively—
 - (a) section 14;
 - (b) section 19CA;
 - (c) section 63H;
 - (d) section 100; and
 - (e) Schedule 8.

Financial, Economic, and Sustainability Implications

Financial implications

Currently the ship leasing business is carried out by shipping companies or financial institutions in Hong Kong. It would be difficult to estimate the revenue forgone arising from the proposed tax concessions as the incentive intends to attract businesses which otherwise would not be domiciled in Hong Kong. That said, the tax revenue foregone due to the new tax concessions is expected to be insignificant. On the other hand, the tax measure may also attract other shipping-related companies pertinent to ship leasing businesses to establish and operate in Hong Kong, and will in turn generate additional tax revenue and bring positive impetus to Hong Kong.

Economic implications

2. The proposed tax concessions for ship leasing activities would help attract the set-up of related business establishments in Hong Kong, thereby generating further demand for the professional services, including maritime business services, financial, legal and accounting services. This would help broaden the depth and breadth of Hong Kong's economy and be conducive to enhancing the status of Hong Kong as an international financial and maritime centre as well as business hub.

Sustainability implications

3. The proposed profits tax concessions would strengthen our competitiveness in attracting ship leasing activities to Hong Kong, which is conducive to the development of the ship leasing business and related professions.