

Hong Kong Tax Alert

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Tax concessions for certain shipping-related activities proposed

On 15 June 2022, the Inland Revenue (Amendment) (Tax Concessions for Certain Shipping-related Activities) Bill 2022 (the Bill) will be introduced to the Legislative Council for the first and second readings¹. The Bill seeks to introduce a dedicated tax concession regime offering tax incentives to qualifying shipping commercial principals, i.e., ship agents, ship managers and ship brokers in Hong Kong. The legislative framework of the proposed tax concession regime is outlined and discussed in this alert.

Clients who have any views or comments on the Bill can relate the same to their tax professionals who will convey their thoughts to the Government in an appropriate manner.

Overview of the proposed tax concession regime

Subject to certain anti-avoidance provisions, the proposed tax concession regime provides that:

- I. qualifying profits of a qualifying shipping commercial principal (i.e., a qualifying ship agent, qualifying ship manager or qualifying ship broker) derived from carrying out a qualifying activity (i.e., a qualifying ship agency activity, qualifying ship management activity or qualifying ship broking activity) in Hong Kong will be taxed at a concessionary tax rate at 8.25% (i.e., half of the normal profits tax rate for corporations at 16.5%); and
- II. qualifying profits derived by a qualifying shipping commercial principal from carrying out a qualifying activity for an associated shipping enterprise², which is entitled to a concessionary tax rate or income exemption under the Inland Revenue Ordinance (IRO), will also be subject to the same concessionary tax rate or income exemption as that applicable to the associated shipping enterprise concerned.

1. The Bill can be downloaded from: <https://www.gld.gov.hk/egazette/pdf/20222622/es32022262215.pdf>

2. An associated shipping enterprise refers to a person who is a ship lessor, ship leasing manager, ship operator or ship owner entitled to tax concessions or exemption under section 14P(1), 14T(1) or 23B of the IRO and (a) over which the qualifying shipping commercial principal has control, (b) which has control over the qualifying shipping commercial principal or (c) which is under the control of the same person as the qualifying shipping commercial principal.

Eligibility to the proposed tax concession regime

Taxpayers must elect in writing if they wish to avail themselves of the above tax concessions. Such an election, once made, is irrevocable for so long as the taxpayers remain as a qualifying shipping commercial principal.

The table below lists out the qualifying requirements for the proposed tax concession regime:

Qualifying requirements	Details
Qualifying shipping commercial principal	<ul style="list-style-type: none"> ▶ A qualifying shipping commercial principal must be a standalone corporate entity solely engaging in the relevant qualifying activity; or satisfy the safe harbour rule by having at least 75% of its total profits derived from and total assets used for the relevant qualifying activity. ▶ Where the corporation fails to qualify as a qualifying shipping commercial principal on the aforesaid condition, the corporation concerned may nonetheless obtain a determination of the Commissioner of Inland Revenue (CIR). The CIR may determine it as being a qualifying shipping commercial principal if he is satisfied that the otherwise non-qualification of the corporation for the year in question arose not out of the ordinary course of business of the corporation.
Minimum number of relevant qualifying activity to be carried out	<ul style="list-style-type: none"> ▶ For both ship agents and ship brokers, the corporation concerned need to carry out at least one or more relevant qualifying activities for a year of assessment; ▶ For ship managers, the corporation concerned need to carry out at least two or more relevant qualifying activities for a year of assessment.
Qualifying activity	<ul style="list-style-type: none"> ▶ A ship agency activity, ship management activity or ship broking activity carried out by a qualifying shipping commercial principal is a qualifying activity if the activity is carried out in the ordinary course of the principal's business carried on in Hong Kong. ▶ A full list of the activities which may be regarded as being a "ship agency activity", "ship management activity" and "ship broking activity" is shown in the Appendix to this alert.
Central management and control requirement	A qualifying shipping commercial principal must exercise its central management and control in Hong Kong.
Substantial activities requirement	<p>A qualifying shipping commercial principal must undertake to carry out the core income generating activities in Hong Kong by:</p> <ul style="list-style-type: none"> ▶ having at least 1 full-time qualified employee in Hong Kong; and ▶ incurring at least HK\$1 million of annual operating expenditure in Hong Kong. <p>In addition to the above objective minimum threshold figures, the Bill also imposes an overarching requirement that the number of persons employed, and the relevant amounts incurred, are in the opinion of the CIR "adequate".</p>

Specific anti-avoidance provisions

The Bill contains the following specific anti-avoidance provisions that would operate to:

- I. reassess a qualifying shipping commercial principal based on the arm's length profits that would have been accrued to it if it did not conduct business transactions with its associated parties on an arm's length basis;
- II. deny a qualifying shipping commercial principal the above tax concessions if the main purpose, or one of the main purposes, of entering into an arrangement is to obtain a tax benefit under the IRO or a tax treaty; and
- III. reduce the tax deduction for service fees paid by a payer who is subject to tax at full-rate to its connected qualifying shipping commercial principal who is subject to tax at half-rate by reference to the amount of tax savings obtained by the qualifying shipping commercial principal from the receipt of the service fees.

Effective date

The proposed tax concessions for qualifying profits of a qualifying shipping commercial principal will apply to sums received or accrued on or after 1 April 2022.

Commentary

We welcome the introduction of the proposed tax concession regime for qualifying shipping commercial principals. The proposal will complement the tax concessions for ship leasing and maritime insurance businesses introduced in mid-2020.

Given that ship agency, ship management and ship broking businesses are important maritime business services supporting international shipping activities, the proposed tax concession regime will help bolster the growth of a vibrant maritime industry cluster in Hong Kong and further consolidate Hong Kong's position as an international maritime center.

The provision of tax incentives is one of the means adopted by other major maritime centers to proactively attract businesses to establish presence in their jurisdictions. For example, under the Maritime Sector Initiative - Shipping-related Support Services (MSI - SSS) Award offered by Singapore, an approved MSI - SSS company will enjoy a concessionary tax rate of 10% on the incremental income derived from the provision of specified qualifying approved shipping-related support services such as ship agency, ship management and ship broking, for a renewable 5-year period.

While the concessionary tax rate of 10% currently offered by Singapore may be less competitive than the 0% or 8.25% rate offered under proposed tax concession regime of Hong Kong, the scope of MSI - SSS Award in Singapore appears to be much wider. For example, the scope of the MSI - SSS Award in Singapore also includes other shipping-related support services such as forward freight agreement trading³; freight forwarding and logistic services⁴; and a wider range of corporate services (e.g., legal services; corporate finance advisory services; information technology support services) which are apparently not covered by the proposed tax concession regime of Hong Kong.

As such, we hope that the Government will further consult industry players and explore the desirability of further extending the scope of the proposed tax concession regime of Hong Kong with a view to ensuring that it is competitive vis-à-vis that of Singapore in terms of promoting Hong Kong as an international maritime center in the region.

Clients who have any views or comments on the Bill can relate the same to their tax professionals who will convey their thoughts to the Government in an appropriate manner.

3. "Forward freight agreement trading" means the undertaking of a position under a forward freight agreement trade where such trade is in connection with shipping freight rates.
4. "Freight forwarding and logistics service" means managing a customer's freight, supply chain or logistics process flow.



Appendix

- ▶ “Shipping agency activity” in relation to a person, means an activity carried out by the person on behalf of a ship lessor, ship leasing manager, ship operator or ship owner (collectively principal) in respect of the principal’s ships, masters and crews, cargoes or customers.
- ▶ “Ship management activity” in relation to a person, means any of the following activities carried out by the person for a ship lessor, ship leasing manager, ship operator or ship owner:
 - a) arranging for or supervising the dry-docking, repair, overhaul, alteration, upkeep, maintenance or lay-up of a ship;
 - b) arranging for the operation, crewing, voyage monitoring, certification, storage or scrapping of a ship;
 - c) ensuring through procurement contracts the adequacy of supplies, provisions, spares, stores and lubricating oil for a ship;
 - d) liaising with relevant authorities or other bodies on safety or manning requirements, or other similar requirements, for a ship;
 - e) appointing a surveyor or any other technical consultant for a ship;
 - f) appointing another person as a ship manager or ship agent, or engaging a stevedore, for a ship;
 - g) supervising the sale (including the physical delivery on sale) of a ship;
 - h) arranging for the provision of bunkers for a ship arranging for the sampling and testing of bunkers for a ship;
 - i) arranging for the sampling and testing of bunkers for a ship;
 - j) ensuring that organizational, flag state, local port state and international requirements applicable to a ship are complied with (including auditing such requirements);
 - k) supervising the general efficiency of a ship;
 - l) handling crew-related matters such as the provision of a qualified crew, the appointment of a crew manager, the provision of crew training, or the arrangement of crew insurance or payroll, for a ship;
 - m) arranging for the transportation of the crew of a ship (including such transportation for their repatriation) or related logistics;
 - n) supervising crew efficiency for a ship;
 - o) ensuring that requirements concerning medical examinations and the possession of medical certificates applicable to the crew of a ship are complied with;
 - p) awarding contracts, entering into alliances, or deciding on pooling, in respect of a ship;
 - q) securing the engagement of a ship by a ship operator for the carriage of cargoes;
 - r) planning a ship’s route and freight tonnage, including the issuance of voyage instructions;
 - s) collecting or arranging for the collection of—
 - i. the freight of a ship; or
 - ii. the charter hire for a ship, or any other payment in exchange for a ship’s use;
 - t) arranging for or providing post-fixture services for a ship, including—
 - i. voyage estimating; and
 - ii. accounting in respect of, or calculating—
 - A. hire;
 - B. freight;
 - C. demurrage; or
 - D. dispatch moneys, due from or to charterers;
 - u) arranging for surveys of a ship;
 - v) making a purchase or sale of a ship, or a decision regarding its ownership;
 - w) deciding on a ship’s flag and registry;
 - x) sourcing for or deciding on financing for the acquisition of a ship;
 - y) arranging for the insurance for a ship or handling relevant insurance claims;
 - z) advising on or supervising the construction, conversion or registration of a ship, including the approval of plans for a ship, based on a ship owner’s requirements;
 - za) arranging for, advising on or undertaking any work requiring technical expertise (including basic design and front end engineering work) for a ship;
 - zb) arranging for or providing marine-related consultancy or technology services for a ship (including ones concerning the environmental, technological and vessel performance aspects);
 - zc) arranging for port agency services or security services for a ship;
 - zd) managing any risks ancillary or incidental to any activity mentioned in any other paragraph of this definition.

- “Ship broking activity”, in relation to a corporation, means any of the following activities carried out by the corporation for a ship lessor, ship leasing manager, ship operator or ship owner–
- a) the broking of sale and purchase of ships;
 - b) the matching of ship owners (who intend to build new ships) to shipyards based on the ship owners’ requirements;
 - c) the matching of ships to–
 - i. cargoes; or
 - ii. ship owners or ship charterers;
 - d) the valuation of ships;
 - e) providing any research, consultancy or advisory service for, or in connection with, an activity mentioned in paragraph (a), (b), (c) or (d) (specified activity) that is carried out by the corporation.

For the purposes of paragraph (e) of the definition of ship broking activity above, any research, consultancy or advisory service provided by a corporation for, or in connection with, a specified activity that is carried out by the corporation during the basis period for the year of assessment concerned is taken to be not so provided if the below specified condition is met.

The specified condition is that the total fees and commissions derived by the corporation from the provision of the service exceed 20% of the aggregate fees and commissions derived by the corporation from the carrying out of all specified activities that are carried out during that basis period.

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