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**Deloitte INED Series**  
**Corporate Treasury Centre**  
**Presented by Davy Yun**

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# Deloitte speaker

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# Content

- Introduction of new law - Corporate Treasury Center
- Tax Incentives: Corporate Treasury Center
- Interest expense: new deduction rule
- Interest income: deeming provision



# Introduction of new law: Corporate Treasury Center

# Corporate Treasury Center (CTC)

- CTC is an “in-house bank” within a group.
- Functions of typical CTCs include:
  - Intra-group financing
  - Multi-currency cash management
  - Cash pooling
  - Central or regional processing of payments to vendors or suppliers
  - Supporting the raising of capital by the group

## Inland Revenue (Amendment) (No.2) Ordinance 2016

- To attract multinational and Mainland enterprises to establish global or regional CTCs in Hong Kong
- Inland Revenue (Amendment) (No.2) Ordinance 2016:
  1. Tax incentives for CTCs
  2. New interest expense deduction rule
  3. Deeming provision for interest income
- The IRD issued Departmental Interpretation and Practice Notes (DIPN) No.52 in September 2016 to provide more guidance

# Tax Incentives: Corporate Treasury Center

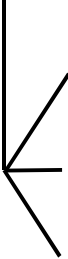
Qualifying Corporate Treasury Centre (CTC) can enjoy 50% of the profits tax rate i.e. 8.25% for the qualifying income from corporate treasury activities

*Apply to the relevant profits accrued on or after 1 April 2016*



## What is a Qualifying CTC?

- Centrally managed and controlled in Hong Kong
- Carry out corporate treasury activities by itself in Hong Kong



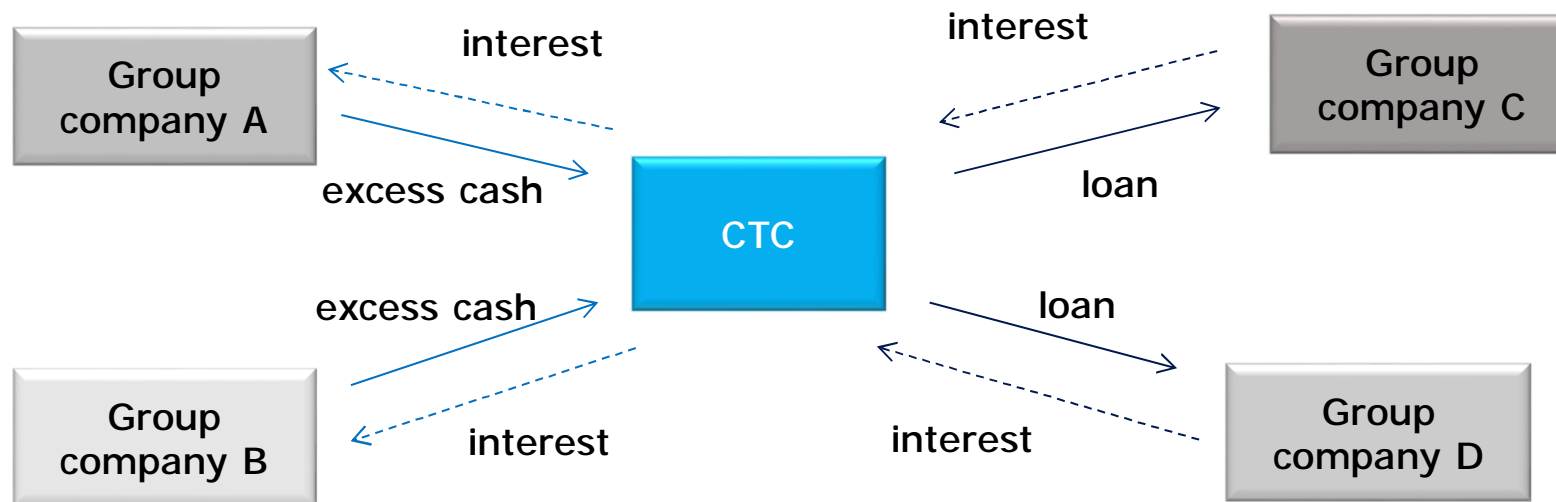
carrying on an intra-group financing business; or  
providing a corporate treasury service; or  
entering into a corporate treasury transaction

- Exclude financial institutions

# Corporate Treasury Activities

## 1. Intra-group financing business

- The business of the borrowing of money from and lending of money to associated corporations
- Typical arrangement: group entities remit excess cash into centralized pool, managed by a designated entity i.e. CTC



# Corporate Treasury Activities

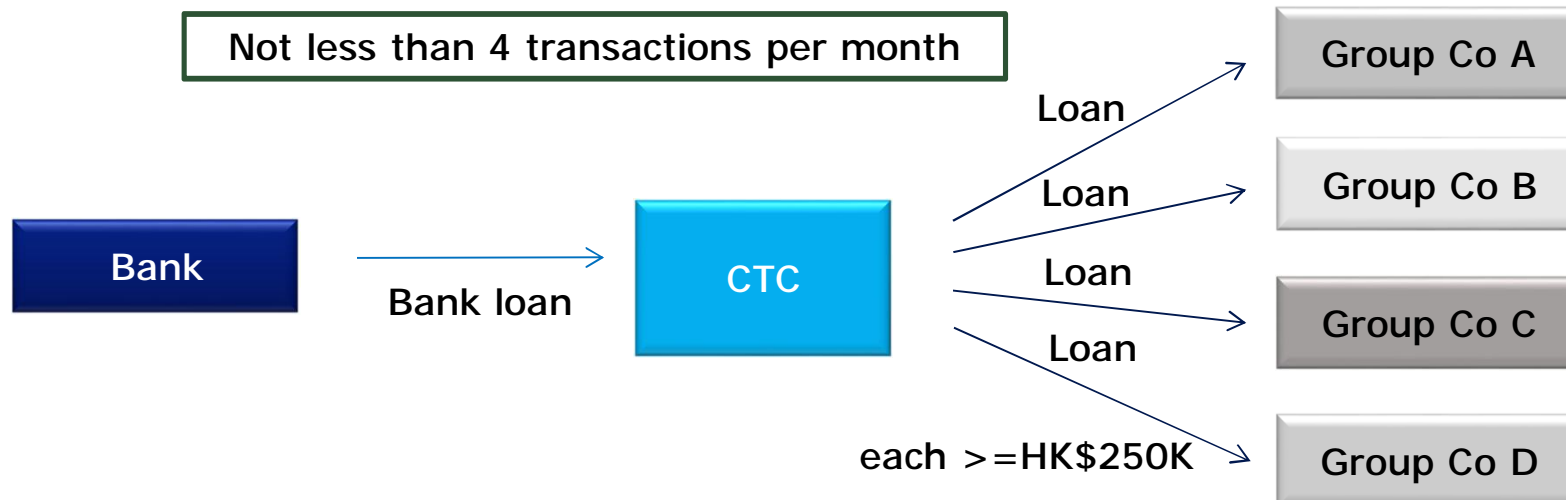
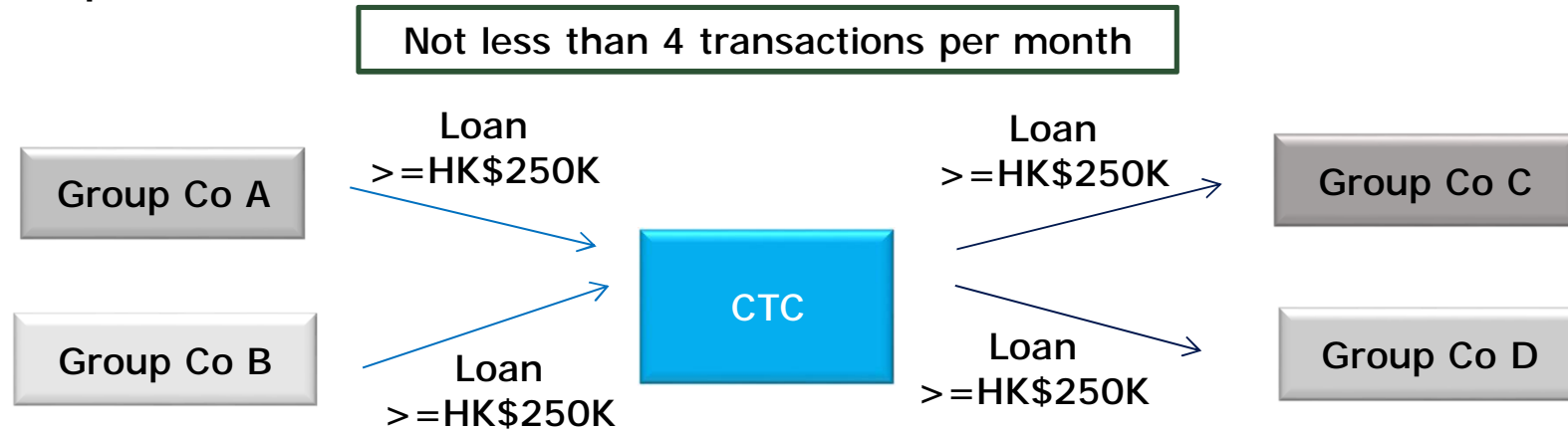
## 1. Intra-group financing business (cont'd)

- Not apply to isolated borrowing and lending transactions
- Benchmark of carrying on an intra-group financing business:
  - Not less than 4 borrowing or lending transactions each month;
  - Each borrowing or lending transaction exceeds HK\$250,000; and
  - Borrowing or lending transactions are with not less than 4 associated corporations in the relevant basis period.
- May qualify even though largely funded by equity or bank loans

# Corporate Treasury Activities

## 1. Intra-group financing business (cont'd)

### Examples



# Corporate Treasury Activities

## 1. Intra-group financing business (cont'd)

- Failure to reach the above benchmark would not necessarily lead to the conclusion that the corporation is not carrying on an intra-group financing business
- Question of fact, factors to be considered:
  - Frequency, repetitiveness, amount of the loans
  - Whether at commercial rates of interest
  - Degree of system and continuity of laying out and getting back of the loan
  - Regularity and frequency of interest payment and repayment of principal
  - Whether a profit is earned
  - Whether the interest charged is on an arm's length basis

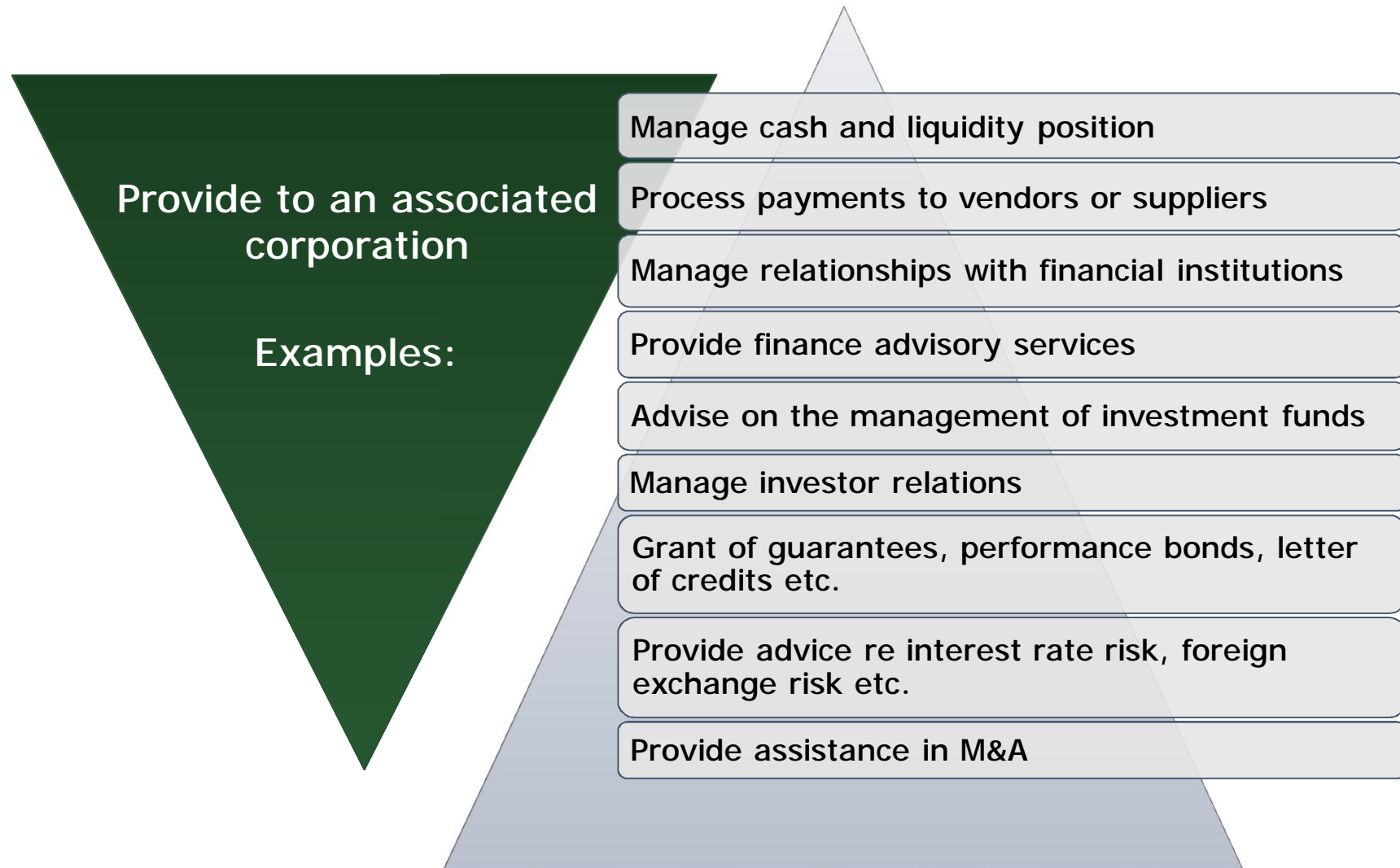
# Corporate Treasury Activities

## 1. Intra-group financing business (cont'd)

- Borrowing and lending regularly as a business with a view to earning an interest margin
- Arm's length principle must be followed when fixing the interest rates for intra-group financing transactions
  - Transfer pricing adjustments may be made by the IRD

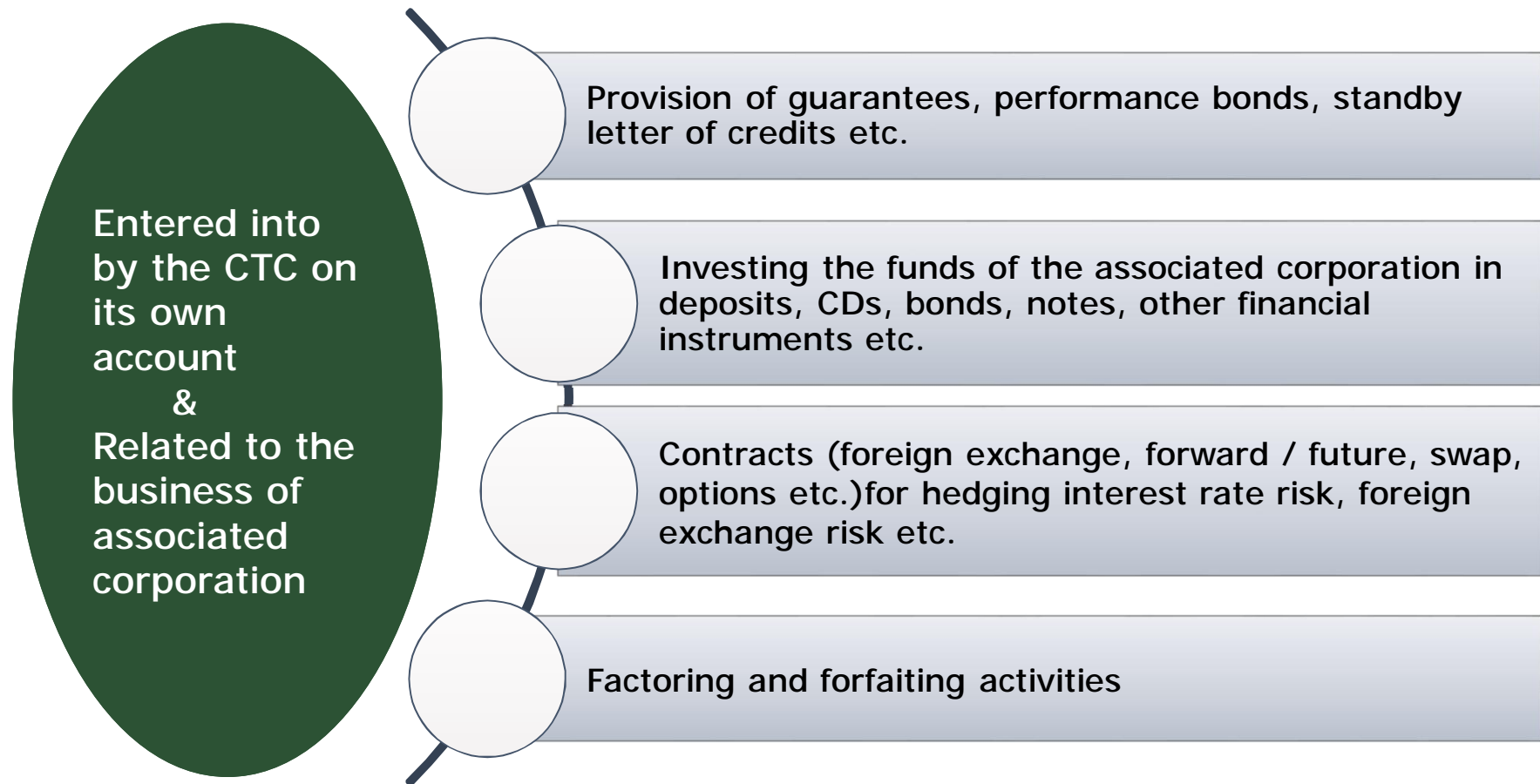
# Corporate Treasury Activities

## 2. Corporate Treasury Services



# Corporate Treasury Activities

## 3. Corporate Treasury Transactions





# What is a Qualifying CTC?

## Standalone entity

cannot carry out other non-corporate treasury activity, subject to safe harbor rules (see next slide)

- Only activities that generate income are considered
- Expense transactions are excluded

### Example

A trading company with a corporate treasury division generally cannot be qualified as CTC, unless safe harbor rules are satisfied

### Example

A company takes a lease of office premises for carrying out corporate treasury transactions in relation to a non-HK associate's business. The transaction of leasing premises would not preclude the company from being qualified as a CTC because this is an expense transaction.

# What is a Qualifying CTC?

## Safe harbor rules

### Corporate Treasury Profit (CTP) test

CTP  $\geq$  75% of total profit

- Based on accounting profits
- Irrespective of the source of profits
- If substantial loss, IRD would consider excluding loss when computing the % for safe harbor rule

and

- Based on audited accounts
- Irrespective of the location of assets
- CTA include fixed assets that are used to carry out corporate treasury activities e.g. office equipment
- Apportion if partly used for corporate treasury activity

### Corporate Treasury Asset (CTA) test

CTA  $\geq$  75% of total assets

### Holding company

The IRD is prepared to exclude equity investment in associated corporations and dividends from the denominators (i.e. total profit / assets) in the above formulas => may satisfy safe harbor rules

# What is a Qualifying CTC?

## Safe harbor rules (cont'd)

### 1-year safe harbor

- Pass both the CTP and CTA tests for the year of assessment concerned

### Multiple-year safe harbor

- Average % of CTP and CTA for the year of assessment and the preceding one\* or two years of assessment can pass both tests  
(\* if carry on business in HK for less than two years)

## Commissioner's discretion

- If neither of the above conditions are satisfied, the Commissioner of the IRD can exercise his discretion to determine that it is a CTC

## Qualifying profits @ half tax rate 8.25%

Intra-group lending	Assessable profits from its loans to non-HK associated corporations in the ordinary course of intra-group financing business
Treasury Service	Income from providing qualifying corporate treasury services to non-HK associated corporations
Treasury Transactions	Income from qualifying corporate treasury transactions related to non-HK associated corporations

## Qualifying profits @ half tax rate 8.25%

### Definition of non-HK Associated Corporations

- An associated corporation that does not carry on business in HK

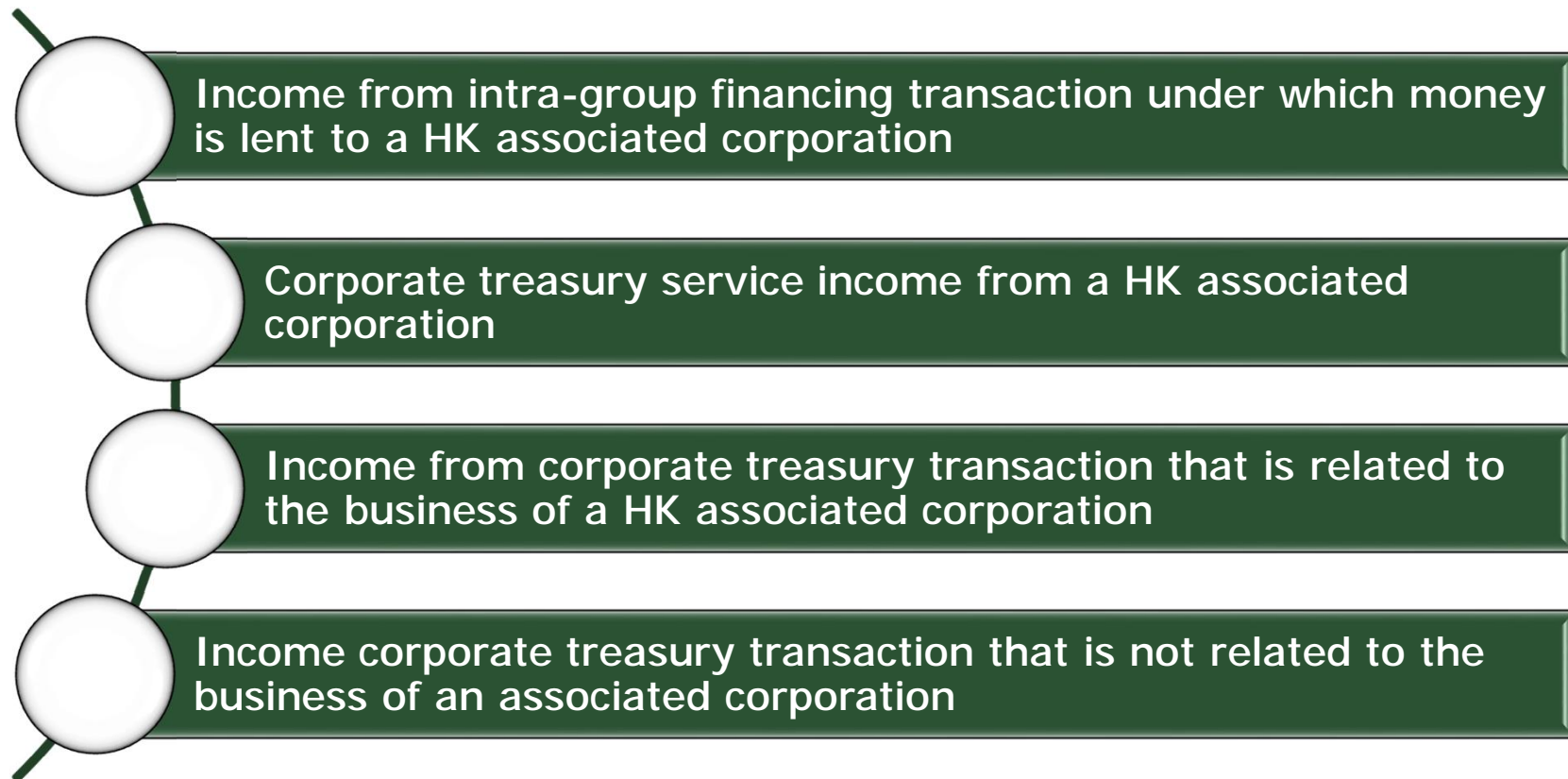
“Associated corporation” means

- Another corporation over which the corporation has control;
- Another corporation that has control over the corporation; or
- Another corporation that is under the control of the same person as is the corporation.

“Control” by means of the holding of shares or voting power

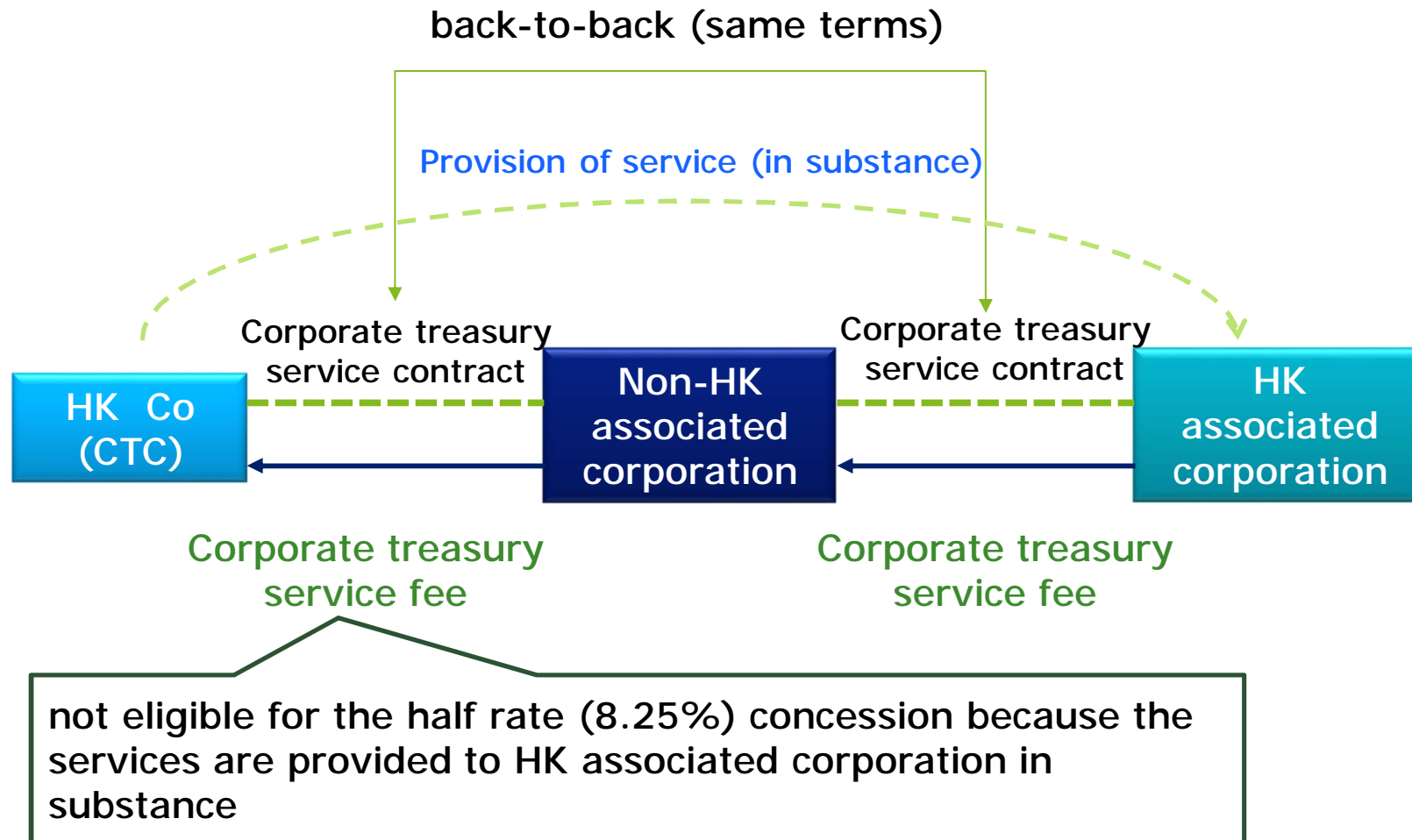
## Non-qualifying profits @ full tax rate 16.5%

### Examples



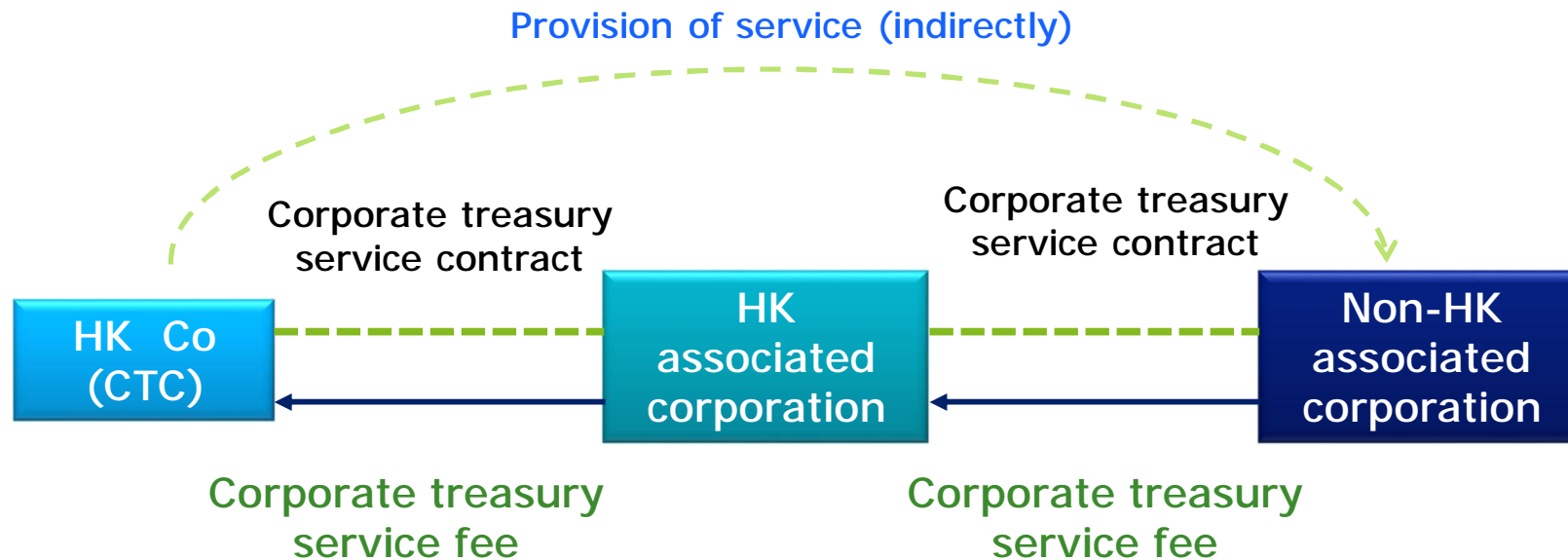
# Non-qualifying profits @ full tax rate 16.5%

Example: back-to-back service arrangement



# Non-qualifying profits @ full tax rate 16.5%

Example: provision of service indirectly



not eligible for the half rate (8.25%) concession because there is no contractual relationship between CTC and the non-HK associated corporation



# Calculation of Qualifying Profits

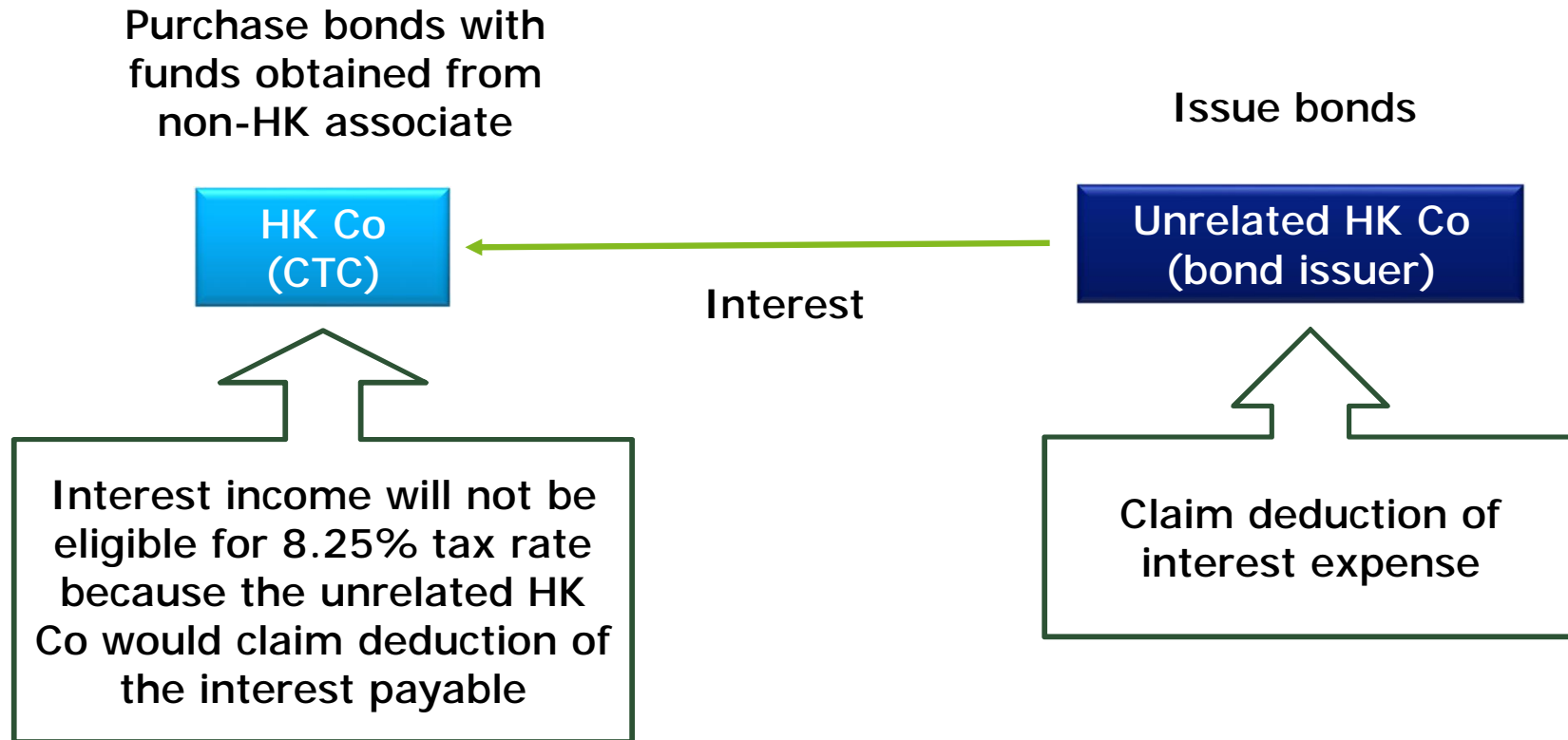
## Apportionment

### Corporate treasury transaction

- Relates to both the business of HK and a non-HK associated corporations
- Apportionment of profits
- Only profits relate to the business of non-HK associated corporation can be taxed at half rate

# Calculation of Qualifying Profits

Example: same sum deducted by another person



*Reference: DIPN No.52 Example 23*

## Election

- Enjoy the concessionary rate by **Election** in writing
- Irrevocable once elected
- If disqualified as a CTC => concessionary rate not applicable for that year of assessment and the following year of assessment
- Once disqualified, the election ceases to be effective
  - Need to make a fresh election when it is entitled to the concession again
- If CTC incurs tax loss from corporate treasury operations, it would not be disqualified
  - Tax loss can only be set off against its other types of profits at half rate

# Interest expense: new deduction rule

# Intra-group Financing Tax Position in the past

## Interest income

- likely apply operations test to determine the source of interest income
- if actively manage the funds and inter-company loan arrangements in HK, it is likely onshore sourced

Taxable

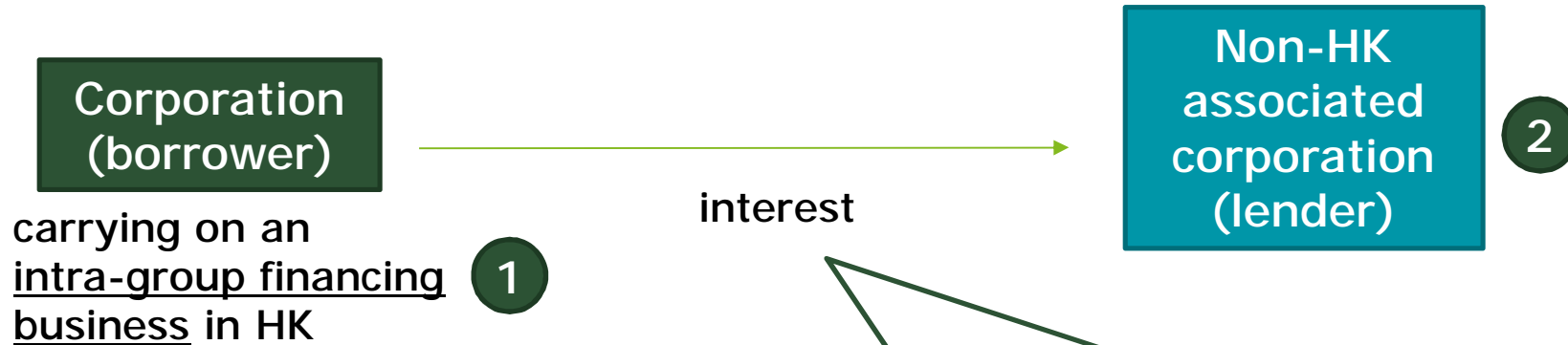
## Interest expense

- recipients not financial institutions
- corresponding interests are not subject to HK tax in the hands of the overseas group companies

Non-deductible



## New interest expense deduction rule s16(2)(g)



Interest expense to non-HK associated corporation is **deductible**, provided that

- paid in the ordinary course of intra-group financing business 3
- the lender is subject to a similar tax outside HK for the interest received 4
- at a rate not lower than HK's reference tax rate (i.e. 16.5% or 8.25% for CTC) 5

Apply to the relevant interest payable on or after 1 April 2016

## New interest expense deduction rule s16(2)(g)

### 1 Carrying on intra-group financing business in Hong Kong

- Same definition of intra-group financing business for CTC
- [Recap] Benchmark of carrying on an intra-group financing business:
  - Not less than 4 borrowing or lending transactions each month;
  - Each borrowing or lending transaction exceeds HK\$250,000; and
  - Borrowing or lending transactions are with not less than 4 associated corporations in the relevant basis period.
- To qualify for interest deduction, the corporation may carry on other businesses, not only intra-group financing business; not necessarily to be a CTC

## New interest expense deduction rule s16(2)(g)

### 2 Interest paid to non-HK associated corporation

- An associated corporation that does not carry on business in HK
- If a corporation merely maintains a bank account in HK without any other business operation in HK
  - Not be regarded as carry on business in HK
- Paid to non-corporate associates (e.g. partnerships, trust) => not allowed for deduction

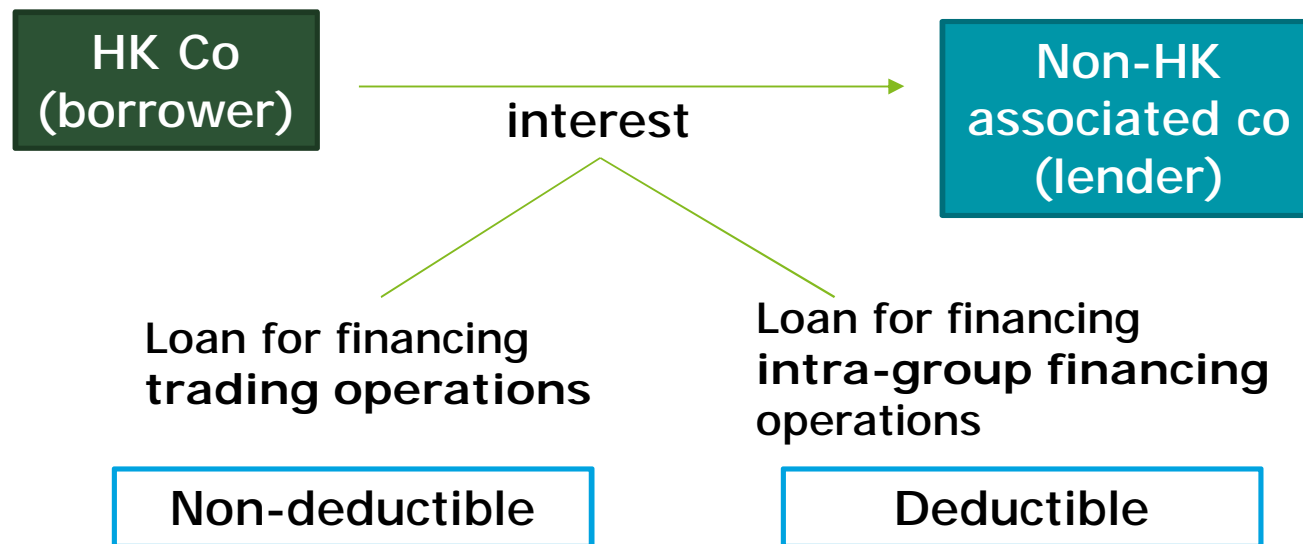


## New interest expense deduction rule s16(2)(g)

### 3 Interest paid in the ordinary course of intra-group financing business

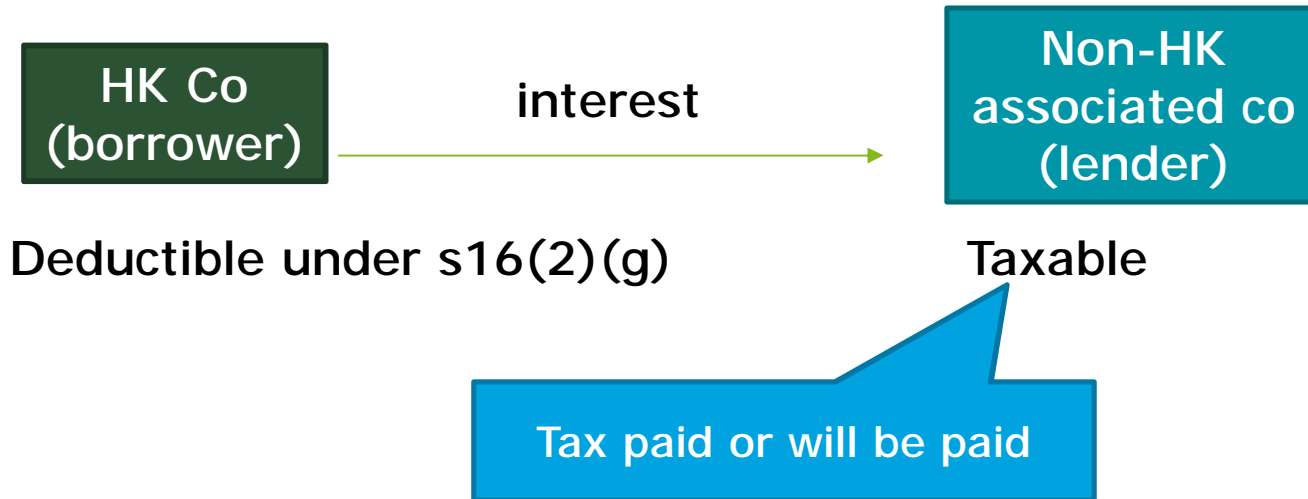
Money borrowed for purposes other than on-lending the same to other associated corporations, the relevant interest not allowed for deduction

#### Example



# New interest expense deduction rule s16(2)(g)

## 4 Subject to tax outside HK



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ü Taxed in a taxable period which ends after that of the borrower in HK (provide evidence upon request)

*(DIPN No.52 Example 1)*

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ü Interest reduced to nil or a negative figure by direct expenses, including the interest expense incurred to produce the interest income (see examples in the next slide)

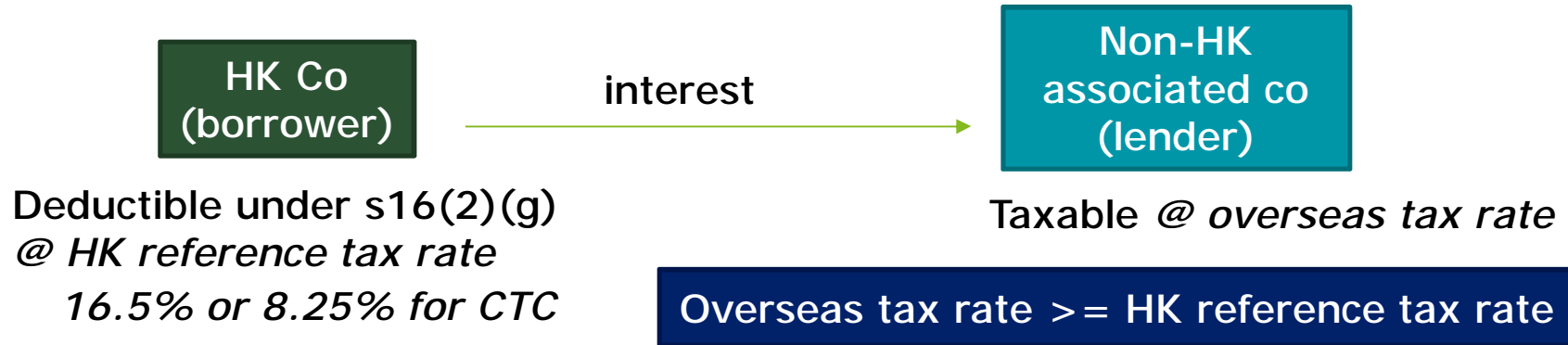
## New interest expense deduction rule s16(2)(g)

### 4 Subject to tax outside HK (cont'd)

- 
- û The lender (non-HK associate) incurs a substantial loss for the year and no tax is payable for that year
- 
- û The lender has losses brought forward which exceed the profits for the year, and no tax is payable for that year (*DIPN No.52 Example 2*)
- 
- û The lender has profits for the year, but no tax is payable due to relief for group losses
- 
- û The lender has profits for the current year, but no profit was made for the money lent to the borrower (e.g. interest income < interest expense)
- 
- û The lender has profits and pays tax for the current year, but the tax paid was fully refunded in the subsequent year due to tax loss carried backward (*DIPN No.52 Example 3*)
-

# New interest expense deduction rule s16(2)(g)

## 5 Not lower than the reference tax rate



Scenario	Overseas tax rate	DIPN No.52
Normal	Actual tax rate applicable under domestic law	Example 4
Progressive tax system	Average rate	Examples 5, 6
Different taxable periods	Compare the tax rates of different periods separately	Examples 7, 8
Net interest income partly set off by loss b/f	Effective rate (i.e. actual tax paid over net interest income)	Example 9
Specific regimes and reliefs e.g. PE, tax treaty, preferential regime, TP adjustment etc.	Specific analysis	Examples 10, 11, 12

In practice, IRD would consider to accept if overseas tax rate is lower than HK reference tax rate by  $\leq 10\%$ .

# New interest expense deduction rule s16(2)(g)

## Anti-avoidance measures

### **Beneficial ownership**

The lender's right to use and enjoy that interest is not constrained by a contractual or legal obligation to pass that interest to any other person

e.g. Conduit company, agent or nominee

- which has very narrow powers
- acting as a fiduciary or administrator
- in conduit arrangements e.g. back-to-back structures
- obliged to pass the interest to another person upon receipt
- under a contractual or legal obligation

⇒ Interest deduction will be denied

Reference: DIPN No.52 Example 13

# New interest expense deduction rule s16(2)(g)

## Anti-avoidance measures

### Interest diversion test [s16(2CA) & (2CB)]

- Combat profit shifting schemes
- Similar to interest flow-back test
- S16(2CA) disallows interest expense
  - where there is an arrangement under which
  - interest will be paid, directly or through an interposed person
  - to a related person who
    - does not pay profits tax in or outside HK; or
    - is required to pay profits tax in HK or outside HK, but at a rate not  $\geq$  HK reference rate (i.e. 16.5% or 8.25% for CTC)
- S16(2CB) provides disallowance by apportionment if during certain period the deduction conditions are not met
- Reference: DIPN No.52 Example 15

# New interest expense deduction rule s16(2)(g)

## Anti-avoidance measures

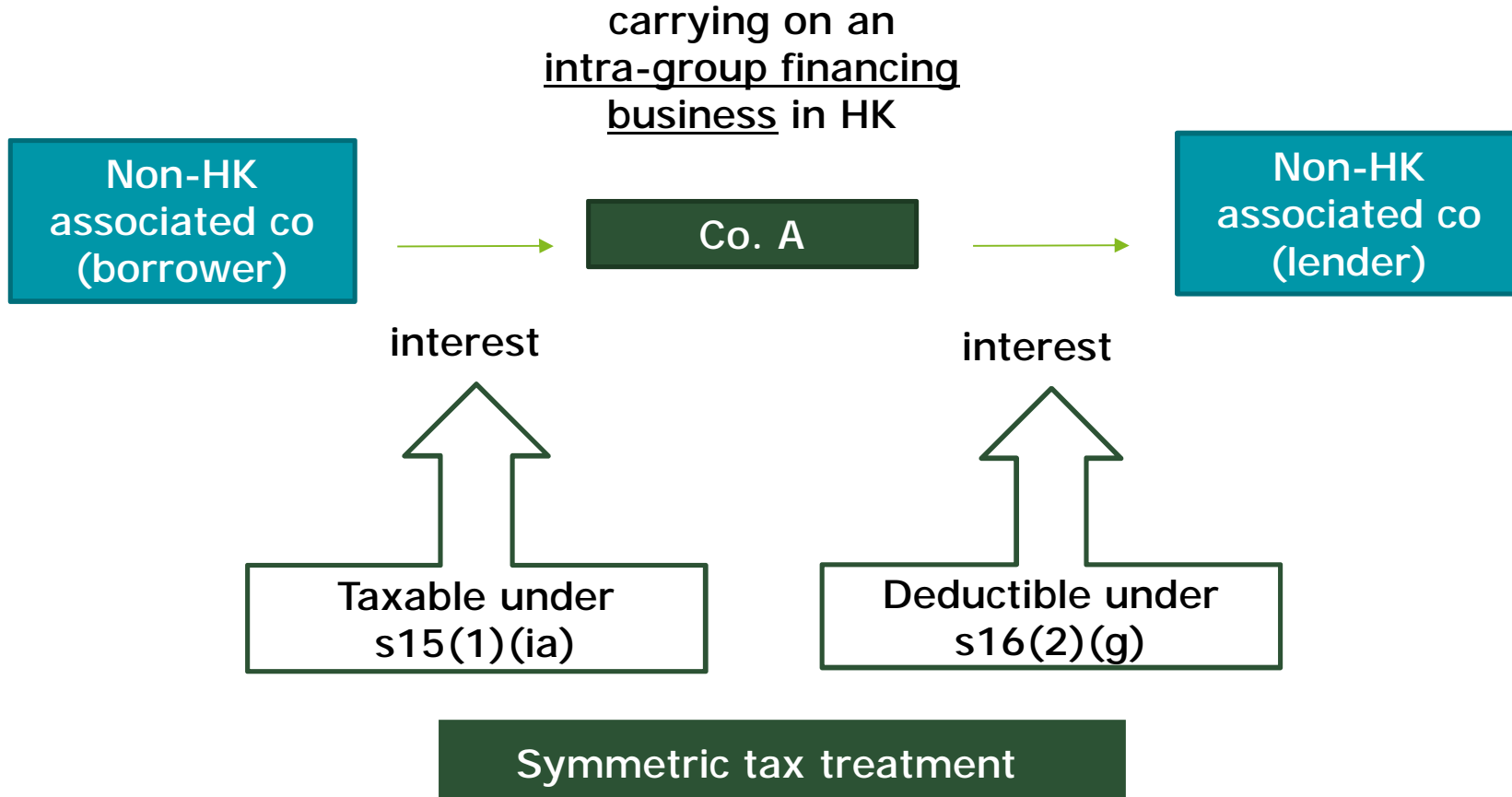
### Loss shifting test [s16(2CC) & (2CD)]

- No deduction is allowed if the main purpose, or one of the main purposes of the borrowing of the money is to utilize a loss to avoid, postpone or reduce any profits tax liability
- More stringent than the “sole or dominant purpose test” under s61A
- Reference: DIPN No.52 Examples 16, 17

# Interest income: deeming provision



# Deeming provision for interest income s15(1)(ia)



## Deeming provision for interest income s15(1)(ia)



Interest income is deemed **taxable**,  
even if the moneys are made available outside HK

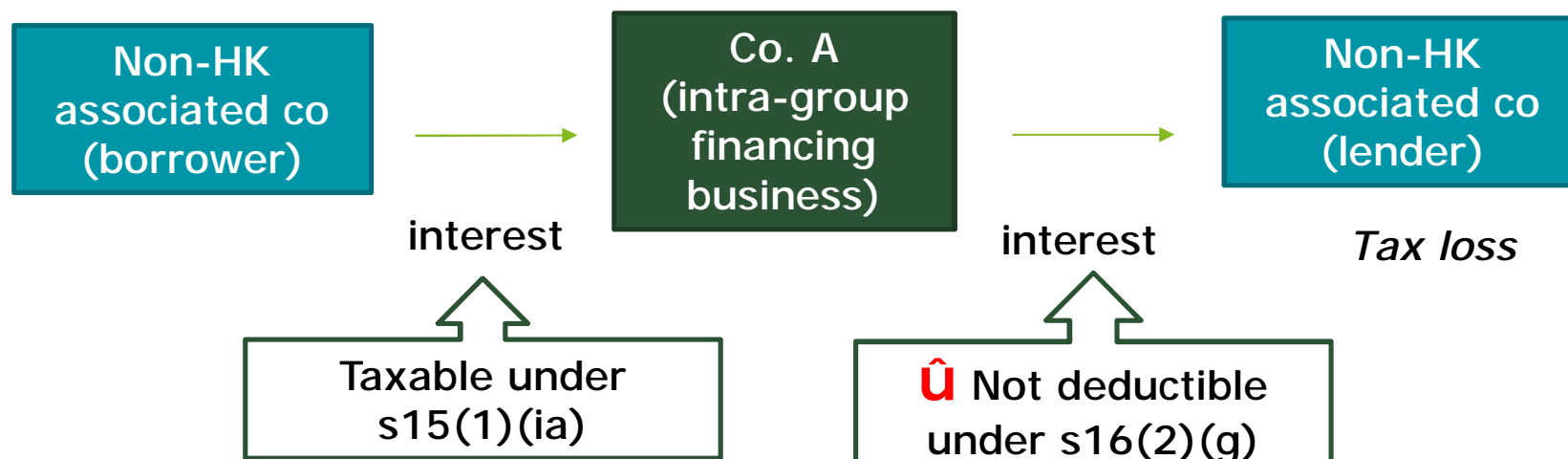
⇒ Apply to sums accrued on or after 3 June 2016

S15(1)(la) – similar to s15(1)(ia); applies to gains from disposal of financial instruments e.g. certificate of deposit, bill of exchange etc.

## Deeming provision for interest income s15(1)(ia)

### Issue 1: Symmetric tax treatment?

- s15(1)(ia) is not written in a way that interest income is taxable provided that the relevant interest expense is deductible.
- What if a company carrying on intra-group financing business but not qualified for interest deduction e.g. cannot satisfy “subject to tax” condition under s16(2)(g)?
- Will the interest income be deemed taxable under s15(1)(ia), while the relevant interest expense is not deductible?



## Deeming provision for interest income s15(1)(ia)

The IRD reiterated in DIPN No.52 that:

To determine the source of interest income for **intra-group financing business**

û Provision of Credit Test

ü Operations Test

- Fund raising
- Negotiation

To determine the source of interest income for **simple inter-company loans** not made in the ordinary course of an intra-group financing business

ü Provision of Credit Test

## Deeming provision for interest income s15(1)(ia)

### Issue 2: Source of profit

- What if a company carrying on intra-group financing business in HK but the operations of certain lending are outside HK?
- s15(1)(ia) "sums received or accrued by way of interest that arises through or from the carrying on in HK by the corporation of its intra-group financing business, even if the moneys are made available outside HK"
- Does a corporation carrying on intra-group financing business in HK still have a chance to claim that some of the interest income are offshore sourced?
- Would it be difficult to argue that the interest income of certain lending transactions (with operations outside HK) do not arise through the intra-group financing business in HK?

## Who would the new rules benefit / impact

May benefit multinational groups or PRC groups looking to create a corporate treasury center to support existing or expanding business operations

May benefit companies looking to restructure existing loan arrangements because of evolving tax landscape e.g. BEPS

Risk of deeming provision applying to Hong Kong companies engaged in intragroup financing activities in Hong Kong but currently rely on the "provision of credit" test



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