HONG KONG TAX ALERT

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Intra-group financing activities in Hong Kong and Hong Kong treasury centres

Intra-group financing arrangements now form a key part in the transfer pricing master file under the OECD Base Erosion and Profit Shifting ("BEPS") initiatives, together with the increase in information transparency these arrangements now need to be properly supported and documented. Hong Kong is also promoting itself as a potential regional treasury hub and has introduced tax incentives.

Summary

- *Under the current tax environment, more focus will be placed on intra-group financing arrangements and these would now need to be properly supported and documented.*
- *The Government has introduced CTC incentives to encourage companies to centralise their treasury functions in Hong Kong.*
- *When setting up a CTC, an important factor to consider is the transfer price(s) applicable to the underlying intra-group financing arrangements.*

Under the current tax environment with the OECD's BEPS initiatives, greater focus will be placed on intra-group financing arrangements. Companies must assess the robustness of these arrangements and determine an appropriate group financing structure. At the same time, there may be opportunities in light of the newly introduced Corporate Treasury Centre ("CTC") incentives.

To provide an attractive environment for multinational and Mainland corporations to centralise their treasury functions in Hong Kong, the Government will allow an interest deduction on certain intra-group financing transactions and introduced a concessionary profits tax rate at 8.25% on certain income of qualifying CTCs. Hong Kong based companies with a treasury function or looking to set up a treasury operation may be able to enjoy the new incentives.

Companies now have the opportunity to explore the new CTC incentives if it:

- Carries on intra-group financing business;
- Provides corporate treasury services to non-Hong Kong associated corporations; or
- Enters into corporate treasury transactions with non-Hong Kong associated corporations.

There has been an increasing trend of companies considering setting up global or regional treasury operations in Hong Kong, to take advantage of Hong Kong's position as an international financial centre, world leading offshore RMB centre and its regulatory and tax regimes. With the introduction of the new CTC incentives, it would encourage more companies to centralise their treasury operations in Hong Kong.

Whether or not to set up a CTC in Hong Kong or other jurisdictions in the region, such as Singapore, requires careful consideration and weighing up of the costs and benefits specific to a group. To evaluate the potential benefit which companies may be able to enjoy under the new CTC incentives in Hong Kong, it would be important to first understand the group structure and the mix of foreign income.

Most importantly companies need to carefully consider transfer pricing. With the more stringent global tax environment and the increase in tax queries on transfer pricing related matters in Hong Kong, companies cannot neglect the importance of having proper transfer pricing to support intragroup financing arrangements.

Typical treasury related transactions or areas which companies should consider when determining the transfer prices include:

- Related party loans or cash pooling arrangements;
- Foreign exchange and risk management activities;
- Guarantee fees;
- Support services provided by the treasury operation to the wider group; and
- Capital structure / thin capitalisation requirements e.g., in China.

In a post-BEPS environment, the lack of a proper transfer pricing framework for intra-group financing arrangements will most likely attract scrutiny from tax authorities. Therefore, appropriate steps should be taken to address transfer pricing when setting up a CTC or entering into any group related finance activities.

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