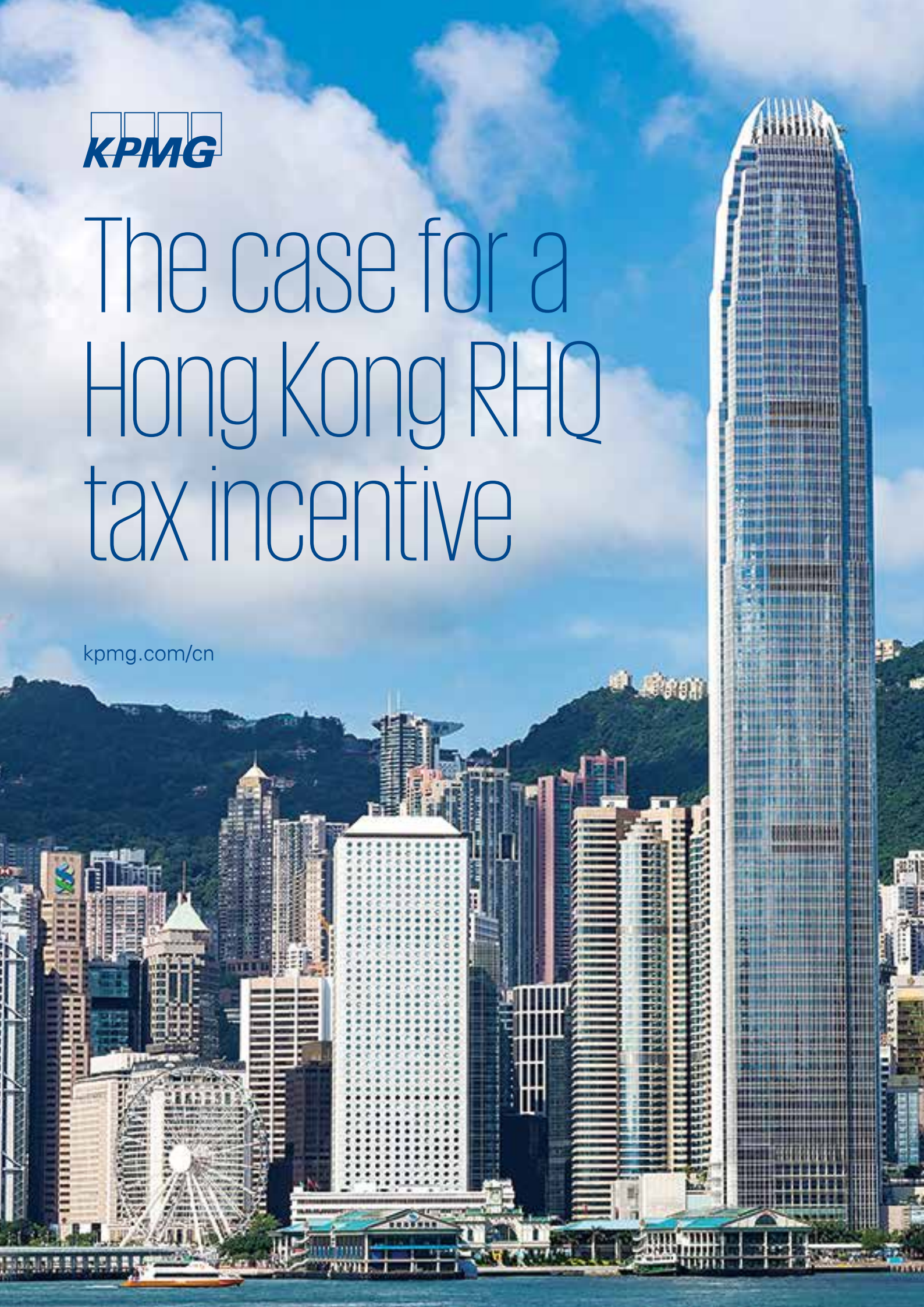




The case for a Hong Kong RHO tax incentive

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1 Executive Summary

The case for a Hong Kong RHQ tax incentive

- The Asia Pacific region is, and is expected to remain for the foreseeable future, the engine room of global economic growth. Multinational corporations (“MNCs”) that operate effectively and that implement sound regional strategies will invariably capture a greater share of the Asia Pacific market.
- A critical component to the success of MNCs operating in the Asia Pacific region is the establishment of effective regional headquarters (“RHQ”). RHQs play a critical role in coordinating and managing an MNC’s resources and in implementing regional strategy.
- An RHQ can bring with it economic growth and development to where it is situated due to the accompanying increased foreign investment, local employment, and demand for goods and services. Furthermore, where a prominent MNC establishes an RHQ in a location, it can increase locational prestige, which could in turn attract additional foreign investment and MNCs, and encourage talented expatriate personnel to relocate. Consequently, governments often implement a number of incentives to attract the establishment of RHQs in their jurisdictions (“RHQ Incentives”).
- A number of factors are considered by MNCs in evaluating locations to situate RHQs, including legal and political stability, taxation, operational costs, time-zone compatibility, proximity to key markets, quality of infrastructure, and availability of talented personnel. In this regard, governments often attract RHQ establishment by implementing RHQ incentives that provide tax concessions and/or facilitate the RHQ’s commercial operations through providing grants/subsidies and/or reducing regulatory barriers.
- In the Asia Pacific region, Singapore has historically been the clear leader as a hub for MNCs establishing RHQs in the region. As an international financial centre and regional business hub, Singapore has many of the traits that MNCs consider desirable in deciding to establish RHQs. Furthermore, Singapore has a bespoke RHQ Incentive regime that can offer tax, commercial, financial and regulatory incentives to MNCs in establishing RHQs.
- As a leading international financial centre and regional business hub, Hong Kong also has many of the attributes of Singapore. However, it does not have a specific RHQ Incentive to attract MNCs to establish RHQs in Hong Kong. A Hong Kong RHQ would generally be subject to tax on its profits at 16.5%, which may be seen as uncompetitive when compared to Singapore’s RHQ Incentive framework where the tax rate is typically around 5% - 10%.
- Statistics also highlight that Hong Kong is not a destination of choice for MNCs looking to establish RHQs in the Asia Pacific region. Additionally, statistics show that US MNCs establishing RHQs in the Asia Pacific region also appear to be leaving Hong Kong. This is a key concern given US MNCs constitute a majority of the world’s largest MNCs. In comparison, Singapore has been dominant in attracting both the world’s largest MNCs and technology companies to establish RHQs in Singapore; such companies are hugely beneficial to economic growth and development.

KPMG’s proposal for an RHQ tax incentive

- To incentivise RHQ establishment, Hong Kong must implement an RHQ Incentive framework. Given taxation has been identified as the most important consideration for MNCs operating RHQs in Hong Kong, Hong Kong should look to implement an RHQ tax incentive. Furthermore, an RHQ tax incentive would complement the recently introduced corporate treasury centre regime in Hong Kong, as MNCs typically undertake their regional treasury and management functions in the same location and commonly in the same entity.
- A Hong Kong RHQ tax incentive could have the following core features:
 - Require that the RHQ actively manage and coordinate group companies operating in a geographic region on behalf of its parent/headquarter company and receive an arm’s length fee in return.
 - Subject qualifying profits of the RHQ to a 50% profits tax rate reduction (8.25%), in line with other concessionary tax regimes, such as the corporate treasury centre rules.
 - Be implemented by way of a self-assessment by taxpayers/RHQs.
 - Require that the RHQs undertake a certain level of investment into Hong Kong and employ suitably qualified local professionals to perform the RHQ’s core functions.
- The RHQ tax incentive is structured so that qualifying RHQs will have commercial and operational substance in Hong Kong and contribute to the growth and development of Hong Kong’s economy due to the level of economic commitment. These aspects will also assist in ensuring that the RHQ tax incentive is Base Erosion and Profit Shifting (“BEPS”) compliant.
- Over time, the RHQ tax incentive should be self-funding due to the increased tax revenue resulting from the increased economic activity from the RHQ.

2 Introduction

- 2.1. Hong Kong is the leading financial services and treasury centre in Asia. However, when it comes to regional headquarters (“RHQ”), Singapore is the clear leader as an RHQ hub for multinational corporations (“MNCs”) operating in the Asia Pacific region. Singapore’s success is in large part due to the proactive approach of the Singapore Government in attracting RHQs through offering bespoke RHQ incentives and in operating world class science and technology parks to support research, development and innovation.
- 2.2. Singapore’s success as an Asia Pacific RHQ hub can also be attributed to Singapore’s:
- Well-established infrastructure¹
 - Skilled workforce
 - Low tax rate and simple tax system
 - Residents who are typically multilingual with English, Mandarin and Malay language capabilities
 - Stable legal and political system
 - Developed and well-regulated financial market system
 - Functionality as a gateway to trade with South East Asia and increasingly as a bridge between Mainland China and India²
 - Rank as the top destination in Asia for expatriate professionals³ and as the most innovative country in Asia per the *2017 Global Innovation Index*
- 2.3. In comparison, the Hong Kong Special Administrative Region (“HKSAR”) has relied upon its simple and low rate regime and geographical location to attract MNCs to establish RHQs in the HKSAR. As Asia’s leading international financial centre and as an international business hub, the HKSAR also has many of the same attributes as Singapore.
- 2.4. However, unlike Singapore, the HKSAR has no specific RHQ tax incentive. Due to the lack of an RHQ tax incentive, an RHQ based in the HKSAR should generally be subject to tax at 16.5% on its profits from its support services under the current tax regime.⁴ This is a relatively high rate of taxation when compared to applicable tax rates under RHQ tax incentive regimes operating in the Asia Pacific region.
- 2.5. What the HKSAR does have over Singapore, and other countries in the Asia Pacific, is a key geographical strategic advantage due to its proximity to Mainland China.
- 2.6. Mainland China is the largest economy in Asia by GDP⁵ and a key market for many MNCs. Hong Kong being part of Mainland China gives it an inherent ability to function as a platform for Mainland China inbound/outbound investment. The HKSAR has commonly been referred to as a ‘super connector’ between Mainland China and the rest of the World. Notably, 81% of RHQs situated in the HKSAR had a geographic responsibility for business operations in Mainland China in 2016.⁶

¹ Mercer’s 2017 ‘Quality of Living Survey’ ranked Singapore as having the best city infrastructure of the countries surveyed.

² APAC Regional Headquarters’ 2016 by Cushman & Wakefield Research.

³ Mercer’s 2017 ‘Quality of Living Survey’ ranked Singapore as the top destination in Asia with a ranking of 25, above Hong Kong’s ranking of 71.

⁴ On 11 October 2017, Carrie Lam, the Chief Executive of the HKSAR, announced in her policy speech that a ‘two-tier’ graduated profits tax rate system would be introduced in 2018 that would subject the first 2m HKD of profits of all enterprises to 8.25%; whereas profits in excess of 2m HKD would be subject to the standard 16.5% profits tax rate.

⁵ Based on 2017 data from the World Bank.

⁶ Chart 4 of the ‘Report on 2016 Annual Survey of Companies in Hong Kong Representing Parent Companies Located outside Hong Kong’ by the Census and Statistics Department of the HKSAR.

- 2.7. However, despite the HKSAR's strategic geographical advantage, Singapore has been able to establish a dominant lead over HKSAR (and Asia Pacific region countries generally) as a preferred RHQ location for MNCs operating in the Asia Pacific region.
- 2.8. In 2016, HKSAR had 1,379⁷ RHQs compared to 4,200 RHQs situated in Singapore.⁸ Whilst there is no clear cause for the disparity, it is clear that the HKSAR must consider incentivising MNCs to pivot to the HKSAR as a favoured RHQ destination in the Asia Pacific region. In particular, the HKSAR needs to take active steps to replicate the success of Singapore's RHQ incentive framework. Additionally, the HKSAR's functionality as a Mainland China 'super connector' should be supplemented by favourable non-tax policies to incentive RHQ establishment by MNCs – such non-tax policies have not been considered in this report.
- 2.9. The benefits to the HKSAR of being a favoured RHQ destination for the Asia Pacific region are numerous, and include increased prominence as an international financial centre/business hub, investment, employment and demand for goods and services in the HKSAR. All of these should be core focus areas of the HKSAR Government to bolster economic growth.
- 2.10. To incentivise the establishment of RHQs in the HKSAR, there are many potential tools at the HKSAR's disposal. These range from financial incentives, which include introducing targeted RHQ financial subsidies and an RHQ tax incentive, through to implementing favourable commercial and regulatory measures, such as further government investment in technology/business hubs and relaxing employment visa requirements for certain skilled personnel.
- 2.11. A 'simple and low tax' tax system has been identified as a key consideration for MNCs in establishing RHQs/regional offices/local offices in the HKSAR.⁹ Furthermore, comparable international financial centres and business hubs in the Asia Pacific region, such as Singapore, Shanghai and Japan, have had success in implementing RHQ tax/financial incentive frameworks.
- 2.12. The introduction of an RHQ tax incentive regime would remove a competitive disadvantage of the HKSAR as an RHQ location in the Asia Pacific region and address a key MNC consideration for RHQ establishment. Furthermore, an RHQ tax incentive would complement the corporate treasury centre tax regime to better establish the HKSAR as a regional management and financing hub for MNCs operating in the Asia Pacific region. These functions are often carried out in the same location and commonly in the same entity.

⁷ 'Report on 2016 Annual Survey of Companies in Hong Kong Representing Parent Companies Located outside Hong Kong' by the Census and Statistics Department of the HKSAR.

⁸ 'APAC Regional Headquarters' 2016 by Cushman & Wakefield Research and cited on the Singapore Economic Development Board website: <https://www.futurereadysingapore.com/2017/the-case-for-centralization-in-asia.html>.

⁹ Chart 12 of the 'Report on 2016 Annual Survey of Companies in Hong Kong Representing Parent Companies Located outside Hong Kong' by the Census and Statistics Department of the HKSAR.

3

The RHO landscape in the Asia Pacific region

- 3.1. The Asia Pacific region is expected to remain the single largest contributor to global GDP through to 2030.¹⁰ On a global scale, Asia-headquartered MNCs are becoming increasingly significant and accounted for the largest group in the *Fortune Global 500* in 2016; currently 100 of the world's largest MNCs are headquartered in Mainland China.
- 3.2. The growth, development and success of MNCs in the Asia Pacific region will depend in large part on how well they operate and capture market share in key markets, such as China, Japan and the South East Asia region.¹¹ In this regard, a crucial component to the success of an MNC's Asia Pacific regional strategy and operations is the implementation of an effective RHO.
- 3.3. RHOs can be critical to the success of an MNC operating in the Asia Pacific region, as they centralise the management function and coordinate resources within the Asia Pacific region to where they are most needed and effectively utilised. In particular, RHOs are often expected to undertake functions which include the following:
- Oversee and evaluate regional performance
 - Coordinate and manage regional personnel and resources
 - Implement and design regional corporate strategies and operational structures
 - Allocate capital/funding on a regional basis
 - Function as a regional treasury centre
 - Manage regional resource procurement
 - Manage and oversee key regional supplier/customer relationships
- 3.4. When MNCs evaluate a location/country for establishing an RHO, they consider a number of factors that are conducive to undertaking the RHO function in an effective and cost efficient manner, which include:
- Geographical strategic importance in terms of proximity to key clients, markets and time-zone compatibility
 - Global competitiveness of the applicable tax regime and ease of compliance
 - Quality of infrastructure, such as transportation, telecommunications, technology
 - Cost of establishing an RHO i.e. rent, personnel, business infrastructure etc.
 - Political stability
 - Whether there are overall improvements to the regional/operational capabilities of the MNC
 - Quality of the legal system and the regulatory environment
 - Favourability of business environment i.e. subsidies, business incubators, innovation centres, etc.
 - Availability of talented personnel
 - Local market operating conditions, such as a quality of business infrastructure, ease of market access and operational efficiency
 - Favourability of expatriate conditions i.e. housing, schooling, environmental conditions, visa access, size of existing expatriate population, etc.
- 3.5. Governments have the ability to influence the desirability of their countries as RHO locations by implementing and enforcing policies, laws and regulations that could have a direct impact on the aforementioned factors.
- 3.6. In the Asia Pacific region, Singapore has by far emerged as the leading RHO destination for MNCs. In 2016, the leading areas for MNCs to establish RHOs in respect of their Asia Pacific operations were Singapore with 4,200 RHOs, followed by the HKSAR with 1,379 RHOs and Mainland China with 649 RHOs (Shanghai 470, Beijing 149).¹² Furthermore, Singapore is not only dominant in terms of absolute Asia RHO numbers in the Asia Pacific region, but also in attracting the world's largest MNCs to establish their Asia RHOs in Singapore.

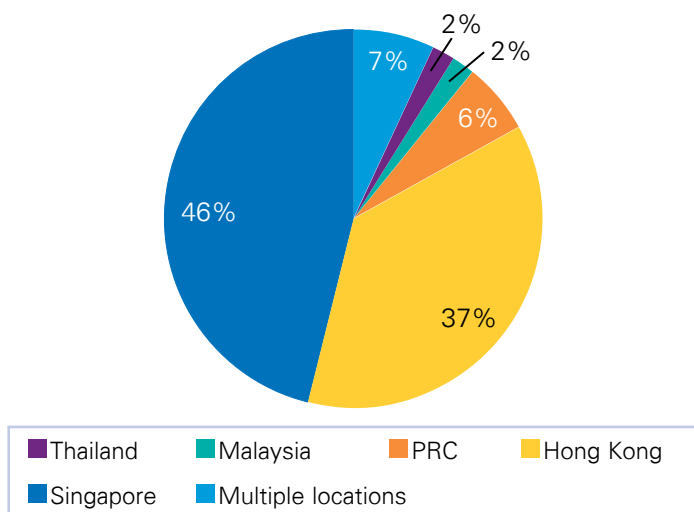
¹⁰ Based on 2017 data from Oxford Economics.

¹¹ Based on data from the World Bank, China's GDP in 2016 of USD 11.199 trillion is more than double Japan's GDP of USD 4.939 trillion, Asia's second largest country by GDP.

¹² APAC Regional Headquarters' 2016 by Cushman & Wakefield Research.

3.7. Graph 1 below shows the location of the Asia RHQ of MNCs sourced from the top 100 MNCs by size in the *Forbes 2017 Global 2000*.¹³ Singapore is depicted in Graph 1 with approximately a 24% lead over the HKSAR as an Asia RHQ location for the World's largest MNCs as ranked by *Forbes*.

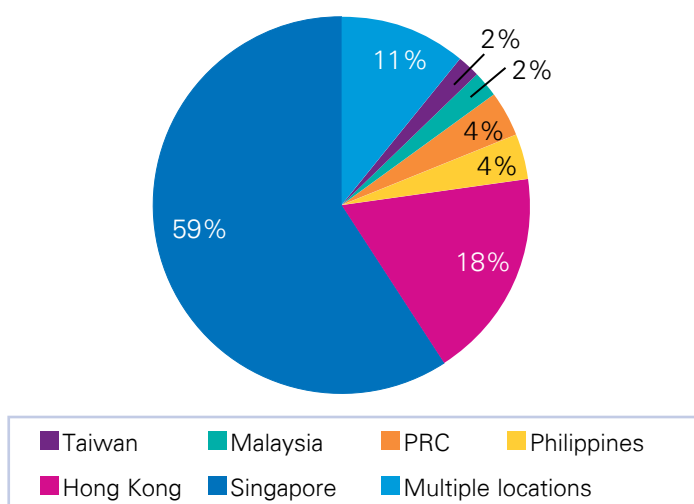
Graph 1: Asia RHQ location for top MNCs



Source: Forbes 2017 Global 2000

3.8. Graph 2 below shows the location of the Asia RHQ of the top 100 technology MNCs¹⁴ by size of the Forbes 2017 Global 2000.¹⁵

Graph 2: Asia RHQ location for top technology MNCs



Source: Forbes 2017 Global 2000

3.9. Graph 2 clearly depicts Singapore as the favoured Asia RHQ location for technology MNCs. Also of note are the number of RHQs of prominent MNCs in the healthcare, technology, media and telecommunications sectors that are currently situated in Singapore, which include: Apple, Alphabet (Google), Facebook, Pfizer, Merck & Co., LinkedIn, Microsoft, Cisco Systems and Twitter. Due to the prominence and prestige of the foregoing MNCs, additional RHQs will be attracted to establish in Singapore and bring with them a skilled and knowledge-based workforce and increased foreign investment. These factors are all conducive to the economic growth and development of Singapore.

The competition for attracting RHQs in the Asia Pacific region

3.10. There is intense competition between countries (and cities) in the Asia Pacific region to attract the establishment of RHQs given the resulting increase in economic growth and development from foreign investment, employment and demand for local goods and services. Furthermore, the situation of the RHQ of a prominent MNC in a country/city will bring with it increased prestige and brand value to potentially attract further foreign investment and skilled expatriates, all of which lead to sustained growth and development of the broader economy.

3.11. In the Asia Pacific region, there are a number of countries that encourage the establishment of RHQs through offering a combination of financial and non-financial incentives, which can include the following:

- Concessionary rates of taxation for profits derived from RHQ activities and in some instances, on the salaries of certain RHQ employees
- Relaxation of employment and travel restrictions for skilled foreign personnel
- Free movement of inbound and outbound capital/funds from the RHQ
- Reduced, to no taxation, on repatriations of certain RHQ profits
- Exemptions from certain duties/tariffs
- Relaxation of business regulations and trade barriers, particularly those governing the operational activities of the RHQs
- Providing specialised facilities and location specific incentives (i.e. science and technology parks)

3.12. Countries in the Asia Pacific region which currently have RHQ incentive frameworks include: Mainland China,¹⁶ Japan, Malaysia, Philippines, Singapore, Sri Lanka, Taiwan, and Thailand. Australia has a limited RHQ tax incentive by way of providing a non-resident withholding tax concession in respect of dividends paid by RHQs that are sourced from foreign income.¹⁷

3.13. In stark contrast to the abovementioned countries, the HKSAR has no specific RHQ incentive framework.

3.14. The following section provides an overview of the various RHQ incentives offered in comparable countries in the Asia Pacific region to the HKSAR and the corresponding conditions that need to be met in order to qualify.

¹³ Not all of the top 100 MNCs by size in the *Forbes 2017 Global 2000* have RHQs/an RHQ in the Asia Pacific region; these MNCs have been omitted from the graph. Of the top 100 MNCs by size in the *Forbes 2017 Global 2000*, 54 of them have an RHQ in the Asia Pacific region.

¹⁴ 'Technology MNCs' is comprised of MNCs in the following industries as categorised in the *Forbes 2017 Global 2000*: Biotechnology, Communications Equipment, Computer Hardware, Computer Services, Electrical Equipment, Electronics, Semiconductors, Software & Programming and Telecommunication Services.

¹⁵ Not all of the top 100 technology MNCs by size of the *Forbes 2017 Global 2000* have RHQs/an RHQ in the Asia Pacific region; these MNCs have been omitted from the graph. Of the top 100 technology MNCs by size in the *Forbes 2017 Global 2000*, 46 of them have an RHQ in the Asia Pacific region.

¹⁶ Provinces in Mainland China which have RHQ incentive regimes are: Shanghai, Beijing, Shenzhen, Guangzhou, Tianjin and Nanjing.

¹⁷ Division 802 of the Income Tax Assessment Act 1997.

4

RHQ incentive frameworks in the Asia Pacific region

- 4.1. Although a number of countries in the Asia Pacific region offer RHQ incentives, not all the countries/locations are comparable and relevant to the HKSAR in terms of geography, prominence and functionality as an international financial centre and business hub.¹⁸ Consequently, only the respective RHQ incentive regimes offered in Singapore, Shanghai, Japan, Malaysia, Thailand, and the Philippines (“Asia RHQ Locations”) have been considered in summary format in Appendix A.
- 4.2. In Appendix A, the components of the respective RHQ incentive regimes offered in the Asia RHQ Locations have been broadly separated into the following tables:
- **Table 1:** Conditions that need to be met to qualify for the RHQ incentives (“Qualifying Criteria”)
 - **Table 2:** Tax and non-tax incentives provided to RHOs that meet the Qualifying Criteria (“RHQ Incentives”)
- 4.3. The summary tables in Appendix A respectively provide a high level comparative overview of the Qualifying Criteria and the RHQ Incentives as between the Asia RHQ Locations.
- 4.4. Based on the summary tables in Appendix A, a number of common core concepts emerge for RHQ incentive frameworks across the Asia RHQ Locations with respect to both the Qualifying Criteria and the RHQ Incentives, which are discussed in further detail below.

The Qualifying Criteria

Regulation and governmental oversight

- The RHQ does not necessarily need to be a locally incorporated company. However, they are generally subject to annual reporting requirements and governmental supervision/oversight.

Local investment and employment requirements

- There are typically local investment and spending conditions that must be met. In some instances, there are also requirements to employ a certain number/type of local personnel.

¹⁸ For context and background, refer to Graph 1 and Graph 2 for an overview of key locations for RHOs in the Asia Pacific region.



Provision of services to offshore associated companies

- The RHQ must provide a specific range and type of services to offshore associated, or wholly owned subsidiary companies.
- The services that must be provided are of a regional managerial nature and include the design and implementation of regional business strategy, allocation of capital/funding to regional companies, monitoring and evaluating regional performance, and coordinating regional resources.

RHQ Incentives

Tax concessions

- Almost all the Asia RHQ Locations provide a concessionary rate of taxation on qualifying RHQ profits i.e. profits derived from the provision of certain RHQ services. Furthermore, special tax incentives are also available in some of the Asia RHQ locations, including withholding tax exemptions on repatriations of RHQ profits, accelerated capital allowances, tax concessions for expatriate employees, and VAT/duty exemptions.

Increased commercial and regulatory flexibility

- Commercial and regulatory requirements may be lowered for qualifying RHQs enabling greater ease in matters which include obtaining certain business licenses and repatriating funds offshore.
- In Asia RHQ Locations where there are restrictions on foreign ownership of real estate, qualifying RHQs may be granted permission to acquire certain types of real estate that are relevant to it undertaking its RHQ function.

Expatriate concessions

- Tax concessions may be granted for employees of qualifying RHQs in the form of personnel tax reductions, travel tax exemptions and import duty exemptions for personal effects.
- Expatriate personnel may be granted visa concessions enabling them to obtain visas via an expedited process and also to freely exit and enter the country.

Financial assistance

- Cash grants/subsidies may be granted to RHQs in respect of certain RHQ investment/functions in view of reducing an MNC's cost of establishing an RHQ.



5

Singapore's RHQ Incentive framework

- 5.1. Over the years, Singapore has introduced a number of incentives to encourage the establishment of Singapore headquarters and RHQs.
- 5.2. In 1986, Singapore introduced a concessionary tax scheme for RHQs called the 'Operational Headquarter' ("OHQ") incentive. The OHQ incentive broadly provided tax incentives in the form of a reduced corporate tax rate of 10% on qualifying profits¹⁹ (compared to prevailing corporate tax rates approximating 20% at the time) and a tax exemption for dividends.
- 5.3. The purpose behind the OHQ incentive was to encourage MNCs to situate RHQs in Singapore as a platform for their business operations in Asia.
- 5.4. In 1991, to incentivise the establishment of a regional financing function for MNCs in Singapore, the Finance and Treasury Centre Tax Incentive ("FTCTI") was introduced. The FTCTI previously provided a concessionary tax rate of 10% on certain interest and treasury services income (which has now been reduced to 8%)²⁰ and provides a withholding tax exemption on qualifying interest payments.
- 5.5. In 2003, two additional RHQ incentives were introduced in Singapore: the Headquarters Award ("RHQ Award") and the International Headquarters Award ("IHQ Award") to broaden and improve Singapore's RHQ incentive framework.
- 5.6. The RHQ Award provides a reduced corporate tax rate of 15% from Singapore's current corporate tax rate of 17% on qualifying RHQ profits.
- 5.7. The IHQ Award implements a bespoke approach to incentivise RHQ establishment in Singapore and provides a corporate tax rate typically in the range of 5% – 10% on qualifying profits. Additionally, other incentives can also be provided, such as grants, concessions on certain trade restrictions, investment allowances etc. However, there are numerous stringent conditions that must be met in order to qualify for the IHQ Award, which are more onerous than required under the RHQ Award.
- 5.8. In view of rationalising and simplifying Singapore's RHQ Incentive framework, the OHQ incentive was repealed from 1 October 2015. Furthermore, the EDB appears not to be considering applicants for the RHQ Award and instead consider applicants for the IHQ Award as a current practice. This is presumably due to the low 2% tax rate differential under the RHQ Award relative to the current corporate tax rate of 17% in Singapore. Consequently, the following section of this paper provides further details on the framework for the IHQ Award, given the RHQ Award currently appears to be of less practical relevance due to the EDB's current practices.

¹⁹ Profits derived from the provision of certain RHQ services to associated offshore network companies.

²⁰ This was reduced to 8% from 25 March 2016 for qualifying entities.

6

Overview of the IHQ Award

- 6.1. The IHQ Award can be granted under the Pioneer Certificate Incentive ("PCI") or the Development and Expansion Incentive ("DEI") schemes, which are both administered and regulated by the EDB.
- 6.2. To qualify for the IHQ Award under the PCI/DEI schemes, an RHO must:
 - Broadly undertake the activities of managing, coordinating and controlling business activities for group companies in Singapore; and
 - Meet a number of quantitative and qualitative criteria ("IHQ Award Criteria").
- 6.3. There are currently no publicly available prescribed guidelines or precise details available in respect of the IHQ Award Criteria. In this regard, all applicants for the IHQ Award must present their business case/plan to the EDB for discussion and evaluation. Following the consultative process with the EDB, the EDB will stipulate certain conditions that must be met by the applicant in order to qualify for the IHQ Award. To this end, the approval and award of the IHQ Award under the PCI/DEI is ultimately dependent on the RHO being able to demonstrate the implementation of a plan that will contribute to growing and sustaining substantive economic activities in Singapore.
- 6.4. Whilst there are currently no publicly available prescribed conditions/guidelines that the EDB consider in determining whether to grant the IHQ Award, applicants for the IHQ Award are generally required to meet the conditions detailed in Appendix B. The conditions outlined in Appendix B have been collated based on those provided by the EDB to recent applicants for the IHQ Award.
- 6.5. The typical timeframe for the EDB to issue a decision regarding the granting of the IHQ is approximately two to three months.
- 6.6. Upon the RHO being granted the IHQ Award subsequent to meeting the required conditions, the RHO can be subject to either 0%, 5%, or 10% corporate income tax on its qualifying income, depending on what was agreed with the EDB. Furthermore, there are other benefits and incentives that can be obtained to supplement the benefit of the concessionary corporate income tax rate. A detailed discussion on the range of RHO incentives typically provided in respect of the IHQ Award is contained in Appendix C.
- 6.7. In order for an RHO to maintain its entitlement to benefit under the IHQ Award, the RHO must annually submit a prescribed form evaluating its performance against a business plan agreed with the EDB, as well as file its income tax returns with the Inland Revenue Authority of Singapore.
- 6.8. If the RHO fails to meet the requisite conditions on an ongoing basis, the IHQ Award could be revoked and the RHO could be liable to reimburse the incentives received.
- 6.9. Once the IHQ Award is granted to an applicant, it will last for a period of five to ten years, depending on what was agreed between the applicant and the EDB.

7

The case for an RHQ tax incentive in Hong Kong

7.1. Despite the many similarities between the HKSAR and Singapore as leading international financial centres and business hubs, Singapore has developed as the leading RHQ jurisdiction for the Asia Pacific region. From a statistical perspective, Singapore had 4,200 RHQs compared to 1,379 RHQs in the HKSAR in 2016.

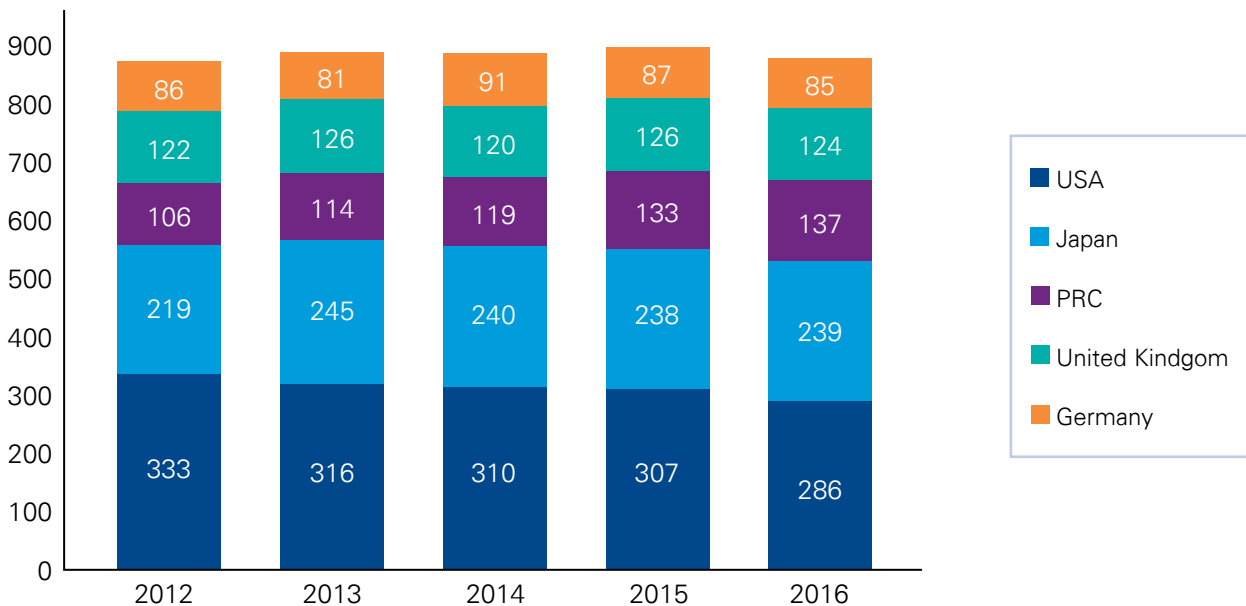
7.2. The HKSAR’s geographical strategic advantage over Singapore in terms of its proximity to Mainland China, Asia’s biggest economy, and corresponding function as a Mainland China ‘super connector’, does not appear to have provided the HKSAR with any discernible advantage over Singapore as an Asia Pacific region RHQ destination.

7.3. Furthermore, recent statistics released by the Census and Statistics Department (“CSD”) highlight Hong Kong’s waning desirability as an RHQ destination.²¹ Graph 3 below has been produced from statistical data obtained from the CSD in respect of the top five parent company jurisdictions.

7.4. Graph 3 illustrates the following:

- In descending order, the following parent company jurisdictions have the most RHQs in Hong Kong: US, Japan, Mainland China, the UK and Germany.
- Over the last five years, the overall growth in the number of RHQs in the HKSAR from the top five parent company jurisdictions has been negligible at 0.58%.
- Since 2012, there has been a:
 - **14% decrease** in the number of RHQs with US parent companies
 - **9% increase** in the number of RHQs with Japanese parent companies
 - **29% increase** in the number of RHQs with Mainland China parent companies
 - **2% increase** in the number of RHQs with UK parent companies
 - **1% decrease** in the number of RHQs with German parent companies

Graph 3: Asia RHQs in Hong Kong – Top 5 jurisdictions of parent company



²¹ <https://www.censtatd.gov.hk/hkstat/sub/sp360.jsp?tableID=133&ID=0&productType=8>.

- 7.5. The establishment of RHQs in the HKSAR bring with it increased foreign investment, prestige, demand for local goods and services, and local employment. Consequently, the negligible overall growth in the number of RHQs in the HKSAR from the top five parent company jurisdictions, and the decrease in the number of RHQs with US parent companies, have concerning implications for future economic development in the HKSAR.
- 7.6. Overall, the top five parent company jurisdictions statistics show that the HKSAR is underperforming in growing and maintaining RHQs.
- 7.7. Firstly, measured against general GDP growth in Asia that is forecast to be 5.3%, 5.5% and 5.4% from 2016 through to 2018 respectively,²² the HKSAR's trend of negligible growth in the overall number of RHQs²³ means that the HKSAR is underperforming in attracting RHQs from growing businesses in Asia.
- 7.8. Secondly, given the dominance of US MNCs globally and the fact that the HKSAR has not been successful in attracting US MNC RHQ establishment, the HKSAR is showing decreased desirability as a destination of choice for the world's top MNCs as an Asia Pacific RHQ location.²⁴
- 7.9. Thirdly, the 29% increase in the number RHQs with Mainland China parent companies seems exceptional at first glance. However, measured against Mainland China GDP growth of 31%²⁵ and outward foreign investment growth of 123%²⁶ over the period, the 29% increase in the number of Hong Kong RHQs of Mainland China parent companies is less stellar.
- 7.10. The statistics above illustrate that there is a clear opportunity for the HKSAR to increase and maintain the number of RHQs established by MNCs. The number of Hong Kong RHQs has increased to 1,413 from 1,379, representing a 2.5% increase from 2016,²⁷ but this is still well below the number of RHQs in Singapore.
- 7.11. Inaction by the HKSAR to explore and implement measures to improve its attractiveness as an RHQ location for the Asia Pacific region, such as an effective RHQ incentive regime, will only result in a continued downwards trajectory in its regional market share for RHQs. In order to ensure the effectiveness of an RHQ incentive regime in the HKSAR, it is critical to understand the key needs of MNCs so that that an RHQ incentive regime can be tailored to address them.
- 7.12. There are a number of potential tools at the HKSAR's disposal to incentivise the establishment of RHQs, ranging from policy and regulatory change, through to financial incentives such as tax concessions, grants and subsidies. However, to increase the effectiveness of any RHQ incentive, the HKSAR should address the areas that MNCs are most concerned about.
- 7.13. Graph 4 below sets out the top 5 considerations of MNCs for establishing an RHQ/regional office/local office in the HKSAR and the corresponding level of 'favourableness'.
- 7.14. Taxation is the most important consideration for MNCs, and the HKSAR appears to have performed reasonably well with a 'favourableness' rating of 73%. However, due to the importance of tax in the decision making process for MNCs and the lack of specific RHQ incentives in the HKSAR, there is still room for improvement.
- 7.15. The HKSAR should consider introducing an RHQ tax incentive to improve its tax system to encourage MNCs to establish RHQs in the HKSAR. Furthermore, the implementation of an RHQ tax incentive would ensure that the HKSAR's tax system is at least on par with its key competitors in the Asia Pacific as a regional business and financial hub, particularly Singapore.

²² 'Regional Economic Outlook: Asia and Pacific, April 2017: Preparing for Choppy Seas' by the International Monetary Fund.

²³ Table 1.1 of the 'Report on 2016 Annual Survey of Companies in Hong Kong Representing Parent Companies Located outside Hong Kong' by the Census and Statistics Department of the HKSAR shows growth of 0.88% from 2012 to 2016.

²⁴ US headquartered MNCs constitute the largest proportion of the world's top 100 MNCs and technology companies as ranked by the Forbes Global 2000 in 2017.

²⁵ The World Bank (2017). National Accounts Data.

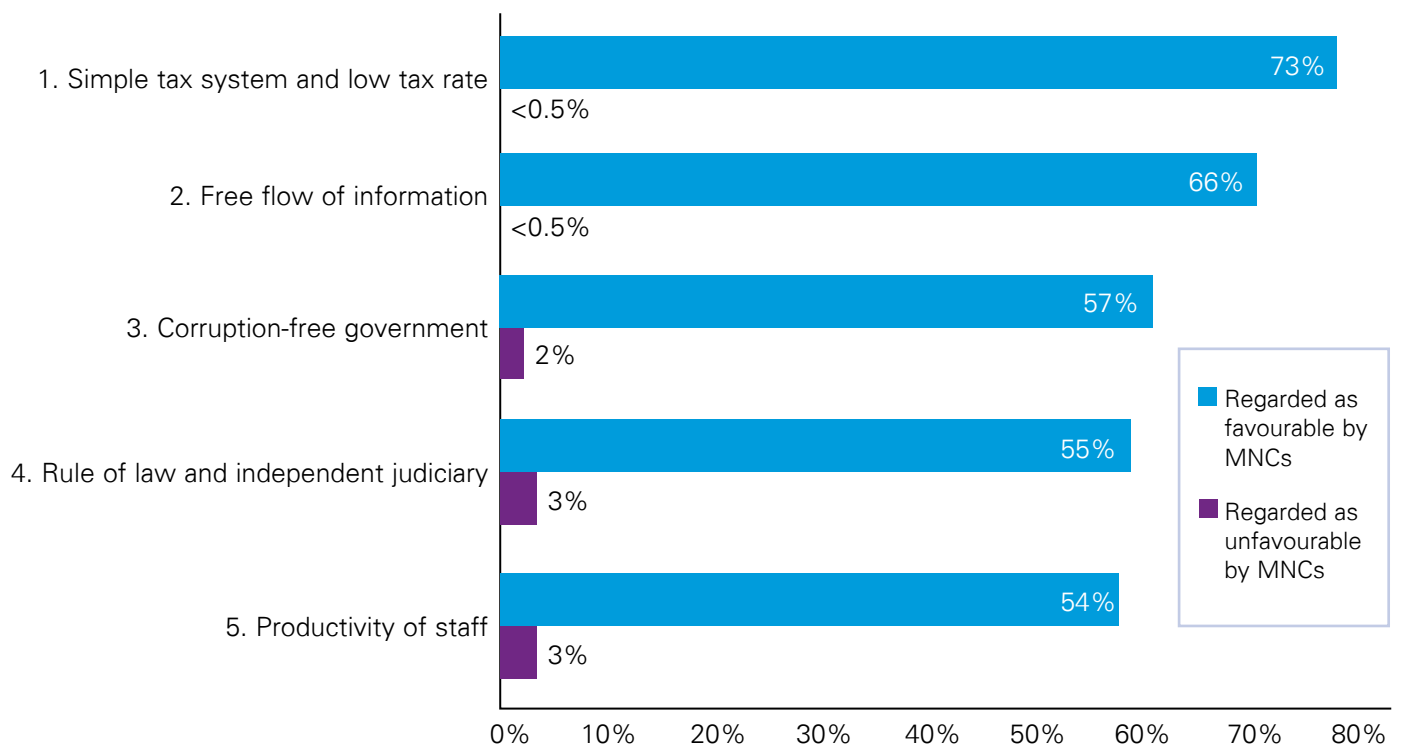
²⁶ Ministry of Commerce of the People's Republic of China (2017). 2016 Statistical Bulletin of China's Outward Foreign Direct Investment.

²⁷ Paragraph 62 of the Chief Executive's 2017 Policy Address – 'We Connect for Hope and Happiness'.

7.16. Whilst other policy options could also be considered, it would take a relatively longer time to explore the viability and effectiveness of such policy options, which could include: increased expatriate visa flexibility, RHQ office rental subsidies, pollution reduction initiatives, greater economic integration with Mainland China etc. However, an RHQ tax incentive could be implemented in the HKSAR with relative ease and has already been proven to be effective in the Asia Pacific region to supplement broader policy initiatives to attract RHQ establishment. Moreover, an RHQ tax incentive in the HKSAR would address an immediate key consideration of MNCs in establishing RHQs, as highlighted in Graph 4.

7.17. A primary strength of the HKSAR's tax system for MNCs establishing RHQs is its simplicity and there being no withholding tax on dividends and interest.²⁸ From a regulatory perspective, there are no restrictive foreign exchange controls. However, a key impediment lies in the HKSAR's 16.5% profits tax rate that would generally be applicable to the profits of Hong Kong RHQs. A 16.5% effective tax rate on Hong Kong RHQs is particularly uncompetitive when compared to concessionary tax rates available under RHQ tax incentive regimes in comparable countries in the Asia Pacific region. This issue is further explored in the following section.

Graph 4: Top 5 MNC considerations



Source: Report on 2016 Annual Survey of Companies in Hong Kong Representing Parent Companies Located outside Hong Kong by the Census and Statistics Department of the HKSAR

²⁸ There can be issues associated with the deductibility of interest where the recipient is neither a financial institution, nor subject to Hong Kong profits tax. However, this adverse outcome can in some instances be alleviated under Hong Kong's corporate treasury centre rules.

8 Recommendations for Hong Kong

- 8.1. Under the HKSAR's territorial tax system, a company carrying on business in Hong Kong and deriving Hong Kong sourced revenue profits from that business will generally be subject to profits tax at 16.5% on those profits.
- 8.2. Given a substantial component of an RHQ's business activities will be the provision of services in the HKSAR, such as regional management and business coordination services to group entities via Hong Kong-based personnel, a Hong Kong RHQ should generally be subject to tax at 16.5% on its profits from its business activities.²⁹
- 8.3. On comparison to the various RHQ Incentives offered in the Asia RHQ Locations,³⁰ an effective 16.5% profits tax rate is comparatively high. Moreover, when the other RHQ incentive measures introduced by competing jurisdictions are taken into account i.e. grants, subsidies, relaxed regulation etc., the HKSAR is a clear outlier and appears particularly uncompetitive as an RHQ destination.
- 8.4. Consequently, the HKSAR should take immediate steps to implement an RHQ tax incentive regime to increase its competitiveness in light of its diminishing attractiveness as an RHQ destination.³¹
- 8.5. The introduction of an RHQ tax incentive would ensure that the HKSAR's tax system is at least on par with its key competitor in the Asia Pacific region, Singapore. Furthermore, MNCs would be encouraged to establish RHQs in the HKSAR, as an RHQ tax incentive would address a key MNC consideration.
- 8.6. A further benefit of an RHQ tax incentive regime in the HKSAR is that it would complement the corporate treasury centre ("CTC") rules introduced in 2016.³² In this regard, MNCs typically situate their regional financing and management hubs in the same location to enable group resources to be more effectively managed on a regional basis. Consequently, an RHQ tax incentive to cover regional management and coordination activities, coupled with the current CTC regime to cover group financing activities, would ensure that the HKSAR has a tax system that is conducive to MNCs establishing an RHQ.
- 8.7. The respective RHQ and the CTC functions are commonly undertaken by MNCs in the same entity to broadly integrate the management function and to pool resources in view of maximising commercial and operational efficiency. However, there is a tax impediment under the CTC rules to the centralisation of these functions into one entity.
- 8.8. Under the CTC rules, the concessionary profits tax rate of 8.25%³³ (50% of the standard 16.5% profits tax rate) will only apply to the profits of a CTC that, amongst other things, fulfils the condition of not carrying out any other activity in Hong Kong other than 'corporate treasury activity'.³⁴ Consequently, a CTC that also undertakes an RHQ function will not qualify for the concessionary 8.25% profits tax rate under the CTC rules.
- 8.9. To address this issue, the CTC rules should be amended to allow CTCs to undertake RHQ activities. However, only its profits from qualifying CTC services³⁵ should be granted the concessionary profits tax rate of 8.25% upon meeting the requisite conditions under the CTC rules. In this regard, profits derived from non-CTC services would need to qualify for the RHQ tax incentive to be taxed on a concessionary basis.
- 8.10. As an alternative to amending the CTC rules, RHQs could instead be allowed to undertake certain CTC functions (but not all, as the CTC rules would operate concurrently) as part of its broader RHQ function under an RHQ tax incentive. The corresponding profits from these CTC activities could then be subject to tax on a concessionary basis under the RHQ tax incentive, rather than under the CTC rules.
- 8.11. In summary, the implementation of an RHQ tax incentive regime would not be a complete solution to attract MNCs to establish Hong Kong RHQs. However, it is an important first step as part of a broader policy effort to improve the HKSAR's standing as an RHQ destination of choice in the Asia Pacific region.

²⁹ On 11 October 2017, Carrie Lam, the Chief Executive of the HKSAR, announced in her policy speech that a 'two-tier' graduated profits tax rate system would be introduced in 2018 that would subject the first 2m HKD of profits of all enterprises to 8.25%; whereas profits in excess of 2m HKD would be subject to the standard 16.5% profits tax rate.

³⁰ Refer to Appendix A for a comparative analysis.

³¹ As illustrated by the trends shown in Graph 3.

³² Pursuant to the Inland Revenue (Amendment) (No. 2) Ordinance 2016.

³³ Under the CTC regime, an 8.25% profits tax rate (50% discount) applies to qualifying profits from certain corporate treasury centre activities from 1 April 2016 pursuant to the Inland Revenue (Amendment) (No. 2) Ordinance 2016.

³⁴ Section 14D(3)(b) of the Inland Revenue (Amendment) (No. 2) Ordinance 2016.

³⁵ Qualifying lending transaction, qualifying corporate treasury service and corporate treasury transaction pursuant to section 14D(1) of the Inland Revenue (Amendment) (No. 2) Ordinance 2016.

9

A broad framework for an RHQ tax incentive in Hong Kong

9.1. The implementation of an RHQ tax regime in the HKSAR should achieve the core objectives set out in Appendix D. Based on the core objectives in Appendix D, a broad framework for an RHQ tax incentive in Hong Kong could have the following features:

Qualifying criteria

- a) The RHQ must be a Hong Kong-incorporated company
- b) The RHQ must meet 'Hong Kong business operating conditions' from a financial and employment perspective by:
 - i. Having at least 15 full-time suitably qualified personnel based in Hong Kong on an ongoing basis performing the RHQ's core functions³⁶
 - ii. Spending at least HKD 10 million on Hong Kong goods, services and infrastructure annually
- c) The RHQ must undertake the active management and coordination of group companies operating in a geographic region ("Network Companies") on behalf of its headquarter/parent company and receive an arm's length fee in return ("RHQ Service Fee").
- d) The RHQ must make an election to become an RHQ with the IRD, and must make an annual declaration in its profits tax return as to whether it qualifies for the RHQ tax incentive.
- e) Notwithstanding that the prescribed conditions cannot be met by the RHQ, the IRD may nonetheless allow the RHQ in question to benefit from the RHQ tax incentive due to the overriding economic benefits to the HKSAR of the RHQ being situated in the HKSAR.

RHQ tax incentive

- a) Upon the RHQ meeting the qualifying conditions set out above, the profits derived by the RHQ from the RHQ Service Fee qualify for a 50% reduction in the prevailing profits tax rate. Whereas profits of the RHQ that are not derived from the RHQ Service Fee ("Non Qualifying Profits") will continue to be subject to the standard rate of taxation.
- b) Tax losses incurred by the RHQ should be treated as they are currently for other concessionary tax regimes under the Inland Revenue Ordinance.³⁷ To this end, where an RHQ has tax losses incurred in deriving:
 - i. Profits from RHQ Service Fees ("Qualifying Profits"), they can be offset against any Non Qualifying Profits subsequent to being reduced to take into account the concessionary tax rate applicable to the Qualifying Profits.
 - ii. Non Qualifying Profits, they can be offset against any Qualifying Profits subsequent to being increased to take into account the standard profits tax rate applicable to the Qualifying Profits.

Any excess tax losses incurred by the RHQ following the above can be carried forward for future offsetting.
- c) Subject to the RHQ meeting the qualifying conditions on an ongoing basis, the RHQ tax incentive can apply indefinitely.

³⁶ Based on Table 2.2 of the 'Report on 2016 Annual Survey of Companies in Hong Kong Representing Parent Companies Located Outside Hong Kong' prepared by the CSD, the majority of RHQs in Hong Kong (53.4%) engage less than 20 personnel.

³⁷ Section 19CA of the Inland Revenue Ordinance.



10

Appendix A

High level comparative overview of
RHQ Incentives in key Asia locations

Table 1: Qualifying Criteria

Qualifying Criteria	Singapore	Shanghai	Japan	Malaysia	Thailand	Philippines
The RHQ must be a locally incorporated company	<i>No, but must be registered</i>	<i>Yes, but branch offices allowed</i>	Yes	Yes	Yes	No
Government department approval required	Yes	Yes	Yes	Yes	Yes	Yes
Investment requirements	<i>Yes, there is a capital contribution requirement</i>	<i>Yes, there are capital contribution and parent company asset holding requirements</i>	No	<i>Yes, there are capital contribution and local infrastructure/service usage requirements</i>	<i>Yes, there is a capital contribution requirement</i>	<i>Yes, there is a capital contribution requirement</i>
Defined scope of RHQ services	Yes	No	No	Yes	Yes	Yes
RHQ services must be provided to associated offshore companies	Yes	Yes	Yes	Yes	Yes	Yes
Commercial requirements	<i>Yes, there are annual business spending requirements</i>	No	No	<i>Yes, there are annual business spending and sales (only for goods based companies) requirements</i>	<i>Yes, there are annual business spending requirements</i>	No
Employment of professionals/skilled staff required	Yes	No	No	Yes	No	No
Annual reporting	Yes	TBC ³⁸	Yes	Yes	No	Yes

³⁸ The Shanghai Ministry of Commerce is still in the process of updating detailed implementation rules to reflect the latest RHQ qualifying requirements/tax incentives.

Table 2: RHQ Incentives

RHQ Incentives	Singapore	Shanghai	Japan	Malaysia	Thailand	Philippines
Corporate tax rate	17%	25%	19% - 23.9% (national tax)	24% 20%/25% (SME)	20% 10% (SME)	30%
Concessionary tax rate	Yes, 0%/5%/10% depending on applicable RHQ regime	No	Yes, 20%	Yes, 0%/5%/10% depending on applicable RHQ regime	Yes, 0%/10% depending on the nature/type of income	Exempt
Special tax incentives	Yes, depending on applicable RHQ regime	Yes, turnover tax exemption	Yes, through special tax deductions for qualifying expenditure, investment tax credits, VAT exemption, and metropolitan tax exemption	No	Yes, concessionary tax rate for individual employees, concessionary withholding tax rates or full withholding tax exemption	Yes, concessionary tax rate for individual employees, exemption for certain local taxes and a VAT exemption/zero rating depending on the applicable RHQ regime
Customs/ import duty exemption	Yes, depending on applicable RHQ regime	No	No	Yes	Yes	Yes
Cash grants/ subsidies/ bonuses	Yes, depending on applicable RHQ regime	Yes, depending on applicable RHQ regime	Yes, depending on applicable RHQ regime	No	No	No
Relaxation in regulatory & compliance requirements i.e. foreign exchange controls, business licenses, trading regulations, property ownership, etc.	Yes, depending on applicable RHQ regime	Yes	Yes	Yes	Yes	No
Expatriate benefits	Yes, depending on applicable RHQ regime	Yes, through ease of cross border travelling	Yes, through ease of cross border travelling, expedited/ simplified immigration process, and support for expats and families to adapt to life in Japan	Yes, through reduced restrictions on expatriate employment	Yes, through reduced restrictions on expatriate employment	Yes, through reduced restrictions on expatriate employment, tax/duty free importation of personal effects, and an exemption from travel tax and immigration fees

Other points of note:

- Singapore, Shanghai, Japan, Thailand and the Philippines offer a range of RHQ Incentives that have not been separately examined in detail in Appendix A.
- Singapore is the only location of the Asia RHQ Locations that provides a full range of bespoke RHQ Incentives. However, there are more onerous requirements that need to be met relative to the standard RHQ Incentive regime offered in Singapore and is subject to negotiation and consultation with the Singapore Economic Development Board (“EDB”). Furthermore, there is no publicly available or standard criteria that the EDB consider in determining whether to grant the RHQ Incentives, as the specific merits of each applicant’s case are considered by the EDB in consultation with the applicant.
- Singapore introduced an Intellectual Property Development Incentive (“IPDI”) from 1 July 2017 that broadly provides for: enhanced tax deductions/allowances for R&D and intellectual property (“IP”) related expenditure, and a concessionary tax rate for IP related income. The IPDI can be utilised in conjunction with Singapore’s existing RHQ Incentive regimes. The precise details pertaining to the operation of the IPDI are expected to be released by the EDB in late 2017.

11

Appendix B

General IHQ Award criteria

- 11.1. The IHQ Award is applicable to entities incorporated or registered in Singapore which provide corporate support and headquarters-related services and business expertise on a regional or global basis. In order to be eligible to apply for incentives under the IHQ Award, the applicant company should meet a number of conditions set by the EDB.
- 11.2. As a general rule, the EDB expects applicant companies to meet the general criteria below:
- a) The applicant should be, or belong to a group that is, well established in its respective business sector or industry and has attained a critical size in terms of equity, assets, employees and business share.
 - b) The applicant should be the nerve centre in terms of organisation reporting structure at senior management levels for its principal activities with clear-cut management and control for the activities.
 - c) The applicant should have a substantial level of headquarter activities in Singapore that may include:
 - Strategic business planning and development;
 - General management and administration;
 - Marketing control, planning and brand management;
 - Intellectual property management;
 - Corporate training and personnel management;
 - Research, development and test bedding of new concepts;
 - Shared services;
 - Economic or investment research and analysis;
 - Technical support services;
 - Sourcing, procurement and distribution; and
 - Corporate finance and advisory services.
 - d) The personnel employed by the applicant for its headquarter operations should be based in Singapore, and include management, professionals, technical personnel and other supporting staff.

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Appendix C

IHQ Award incentives

- 12.1. The IHQ Award offers incentive packages commensurate with the scale and value of the applicant's headquarter/RHQ operations in Singapore. The IHQ Award provides a customised incentive package with concessionary tax rates, typically 5% or 10%, on incremental qualifying income.
- 12.2. In addition to concessionary tax rate to be levied on the incremental income from qualifying headquarter/RHQ related services, applicant companies may seek additional incentive support from the EDB as part of the incentive package under the IHQ Award. Some examples are:
- Approved Royalties Incentive: Partial exemption of Singapore withholding tax for royalties or technical assistance fees payable to non-residents for the transfer of technology.
 - Approved Foreign Loan Incentive: Partial exemption of Singapore withholding tax on interest incurred on foreign loans obtained to purchase productive equipment.
 - Merger and Acquisition scheme: Tax allowance of 25% of the acquisition value, subject to a maximum of SGD 10 million for each year of assessment. It also provides double tax deduction on transaction costs and stamp duty relief.
 - Productivity and training grants: Financial grants to encourage capability development in applying new technologies, industrial R&D and professional know-how, as well as productivity improvements.
 - R&D Incentive Scheme for Companies: Financial grants to develop research and development capabilities in strategic areas of science or technology.

13 Appendix D

RHQ Tax Incentive core objectives

A. Subject the profits of an RHQ derived from the performance of RHQ functions in the HKSAR to a preferential rate of taxation equal to existing preferential rate regimes in the HKSAR

- There is a direct connection between the RHQ function undertaken in the HKSAR and the profits that will be taxed on a preferential basis. In doing so, there is an alignment of RHQ economic activity/value creation in the HKSAR and the taxation outcome.
- The alignment of the preferential corporate rate with existing preferential tax regimes, such as the respective CTC and the aircraft leasing regimes,³⁹ reduces the opportunity and the incentive for taxpayers to undertake tax-driven non-commercial arrangements.⁴⁰
- A single preferential profits tax rate (i.e. a standard 50% rate discount) in the HKSAR's tax rules reduces complexity, particularly if RHQ and CTC functions could be undertaken in the same entity, as profits would not need to be separated for tax computations due to differing tax rates (refer to point B).

B. Operate in conjunction with the CTC rules

- To strengthen the HKSAR's position as an RHQ hub in the Asia Pacific region, the HKSAR's tax rules should support regional management and financing activities. To this end, the RHQ tax incentive should complement the CTC rules to increase the effectiveness and utility of both of these regional incentives. This aspect is particularly important given that the RHQ and CTC functions of MNCs are usually carried out in the same locations and commonly within the same entity.

- To improve the effectiveness and utility of the CTC rules/RHQ tax incentive, consideration should be given to allowing:

- CTCs to undertake RHQ activities under the CTC regime and apply the RHQ tax incentive to non-CTC profits where these profits qualify for the RHQ tax incentive; and/or
- RHQs to undertake certain CTC functions, the profits from which could then qualify for the RHQ tax incentive.

C. Encourage investment into and economic development of the HKSAR by requiring conditions to be met in respect of local business spending and the employment of personnel

- This ensures that the HKSAR's economy benefits from MNC investment when RHQs are established, which will in turn assist the HKSAR in funding the RHQ tax incentive by increasing tax revenue from a growing economy. Ultimately, the RHQ tax incentive should over time be 'self-funding'.
- The requirement of a certain level of investment into the HKSAR by MNCs/RHQs in order to qualify for the RHQ tax incentive, combined with the performance of RHQ functions in the HKSAR, ensures that there is economic and operational substance in the HKSAR which would address Base Erosion and Profit Shifting ("BEPS") concerns (discussed further below in point E).

³⁹ Under the aircraft leasing regime, an 8.25% profits tax rate (50% discount) applies to qualifying profits from certain aircraft leasing activities from 1 April 2017 pursuant to the Inland Revenue (Amendment) (No.3) Ordinance 2017.

⁴⁰ Due to the international and regional nature of the respective CTC and aircraft leasing regimes, there could be instances where there is an overlap in the services provided. In this instance, profits from the services could respectively meet the criteria for taxation under the CTC regime, aircraft leasing regime and the RHQ tax incentive and therefore qualify for taxation under either regime. The alignment of the respective concessionary corporate tax rates of the aforementioned preferential tax regimes would remove the incentive for the non-commercial streaming of income to achieve a more tax advantageous outcome on a group basis.

D. Meet the requisite conditions for applying the RHQ tax incentive on an ongoing basis

- This ensures that there is ongoing investment and economic activity in respect of the RHQ in the HKSAR to continually qualify for the RHQ tax incentive. RHQs intending to benefit from the RHQ tax incentive should undertake an annual self-assessment and make a declaration in their profits tax return that they have met the requisite RHQ tax incentive conditions.

E. Be compliant with the OECD’s BEPS initiative, particularly ‘Action Point 5 – Harmful Tax Practices’ (“Action Point 5”)

- It is important that upon introducing an RHQ tax incentive, the HKSAR is not introducing a harmful tax practice in contravention of Action Point 5 given the adverse implications for the HKSAR’s reputation and desirability as an Asia Pacific RHQ destination.
- The design of an RHQ tax incentive that addresses the above would likely ensure that there is sufficient commercial substance and transparency for the implementation of an RHQ tax incentive in compliance with Action Point 5. Moreover, Hong Kong’s world class business and financial infrastructure, proximity to Mainland China and qualities as a leading international financial centre and business hub support that the RHQ tax incentive would not be a primary motivator for MNCs to situate RHQs in Hong Kong. In other words, Hong Kong would not be perceived as a tax avoidance facilitator by introducing an RHQ tax incentive due to the overriding commercial considerations for establishing a Hong Kong RHQ.

F. Be easy to administer and apply for

- Singapore operates its RHQ incentive (IHQ Award) on a consultative basis via the EDB. The key merits of this consultative approach are the tailoring of RHQ incentives and the flexibility of the EDB in assessing an applicant’s ability to qualify for the IHQ Award. However, despite its benefits, the consultative approach to the administration of the IHQ Award lacks transparency and certainty for applicants, and RHQs could also face delays in benefiting from the IHQ Award due to the time required for the approval process.

- In view of implementing an efficient and transparent RHQ tax incentive, and to also provide applicants with sufficient certainty over its application, the HKSAR should implement a prescriptive and codified RHQ tax incentive framework. Under this approach, RHQs should self-assess their eligibility for the RHQ tax incentive and file their profits tax returns with the Inland Revenue Department (“IRD”) on that basis, as discussed in point D.
- In some instances, RHQs may not qualify for the RHQ tax incentive in the HKSAR due to the prescriptive nature of the conditions that need to be met. However, it may nonetheless be beneficial for the growth and development of the HKSAR’s economy for such RHQs to be situated in the HKSAR. Consequently, to encourage such RHQs to be established in the HKSAR, and to also mirror the benefit of Singapore’s tailored RHQ incentive regime, the RHQ tax incentive should provide the IRD with a discretionary power to grant relief in these special circumstances.
- The operation of the RHQ tax incentive via a self-assessment approach in the HKSAR will ultimately enable RHQs to apply the RHQ tax incentive with certainty and without delay due to a formalised approval process. From an administration perspective, the HKSAR government would not need to allocate specific resources to the administration and regulation of an RHQ tax incentive outside of the IRD. In this connection, the IRD could apply its existing risk-based taxpayer review framework to selectively review certain taxpayers applying the RHQ tax incentive to ensure its correct application.

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