HONG KONG TAX ALERT

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Hong Kong extends profits tax concession for certain insurance businesses

Summary

The enhanced tax concession came into effect on 19 March 2021, providing a concessionary tax rate of 8.25% on income for certain insurance-related businesses conducting business in Hong Kong provided certain thresholds are met.

Taxpayers should review their current mix of business and activities and consider the commercial and tax implications of whether they can avail themselves of the tax concession.

Overview

In recent years, the Hong Kong government has released a stream of tax incentives to bolster the financial services industry. It therefore came as no surprise that the government introduced a concessionary tax regime to further develop the insurance sector and bolster Hong Kong's competitiveness as an international insurance hub and risk management centre. On 15 January 2021, the government gazetted two notices related to Inland Revenue (Amendment) (Profits Tax Concessions for Insurance-related Businesses) Ordinance 2020 which extends the profits tax relief to three additional classes of insurance businesses. The new profits tax concession is now confirmed to apply for specified insurers and licensed insurance brokers on or after 19 March 2021.

The tax concession

Previously, Hong Kong had a concessionary tax regime whereby a profits tax rate of 8.25% (being half of the current profits tax rate of 16.5%) was available to authorized captive insurance business and reinsurance business of professional reinsurers in Hong Kong. Effective from 19 March 2021, the new rules extend the concessionary tax regime to certain qualifying insurance-related businesses as follows:

i. all general reinsurance business of a direct insurer ("specified insurer[1]");
ii. certain types of general insurance business of a specified insurer ("specified general insurance business"); and
iii. certain types of insurance brokerage business of licensed insurance broker companies.

However, there is a specific carve-out for specified general insurance business covering the following five types of risk and liabilities, namely (a) health risk; (b) mortgage guarantee risk; (c) motor vehicle damage risk; (d) employees' compensation liability; and (e) owners' corporation third-party liability.

A specified insurer comprise the following categories of insurers carrying on business in or from Hong Kong:
i. A company authorized by the Insurance Authority ("IA") to carry on any classes of business;
ii. Lloyd's; and
iii. An association of underwriters by the IA.

The new rules contain an anti-avoidance provision (i.e., a main purpose test) to deny the concessions if a direct insurer enters into a transaction or a series of transactions with a person for the sale or purchase of insurance or reinsurance and the main purpose, or one of the main purposes, in entering into the transactions is to avoid or postpone the liability to pay tax or reduce the amount of tax liability (e.g. where direct insurers buy reinsurance among themselves to cede part of their respective risks primarily for a tax benefit).

The new rules also include provisions on:

- ascertaining the assessable profits of the qualifying insurance business that are chargeable to profits tax at 8.25% as opposed to other businesses that are subject to the current profits tax rate of 16.5%
- the treatment of losses where a person derives concessionary trading receipts and normal trading receipts from carrying on qualifying insurance business and other business.

Substantial activity threshold requirements

To meet the international standards on anti-base erosion and profit shifting (BEPS), the Ordinance has included substantial activity requirements that must be met in order to qualify for the concessionary regime. Specifically, the tax concession applies to qualifying taxpayers operating in Hong Kong and require that the core income generating activities are undertaken in Hong Kong provided threshold requirements are met. For general reinsurance business of direct insurers, general insurance business of direct insurers and licensed insurance brokerage companies, the following minimum threshold requirements must be met during the basis period for the year of assessment concerned:

Qualifying activity of:	Number of full-time qualified employees in Hong Kong	Operating expenditure incurred in Hong Kong
A specified insurer which is a mutual insurance corporation	Not less than 4	Not less than HK$2 million
A specified insurer which is not a mutual insurance corporation	Not less than 7	Not less than HK$4 million
A licensed insurance brokerage company	Not less than 3	Not less than HK$1 million

It is worth noting that similar to other concessionary tax regimes (such as aircraft leasing and ship leasing), the Commissioner has the discretion to assess whether the minimum thresholds are adequate in order to qualify for the concession. Further guidance from the Inland Revenue Department ("IRD") on how this will apply in practice is welcome.

KPMG observations

The new tax concession for insurance-related businesses is welcome and could potentially attract more insurers and insurance brokers to set up or relocate their regional hubs to Hong Kong. This also places Hong Kong insurance businesses with a competitive advantage to position itself to capture opportunities for businesses looking to invest in the Belt and Road and Greater Bay Area initiatives.

Taxpayers should review their current operations and activities, and consider the commercial and tax implications of any potential restructuring to meet the qualification requirements. They should also review their operating protocols and Hong Kong presence to ensure that they meet the threshold requirements to enjoy the profits tax concession. We expect that the IRD will issue guidance on the application of the concession in due course, ideally including comments on transition to the new rules.

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