KPMG

Hong Kong Tax Alert

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The proposed profits tax concessions for various maritime services in Hong Kong

Summary

A tax bill was gazetted on 2 June 2022 to introduce a concessionary tax regime for ship agency, ship management and ship broking businesses in Hong Kong.

Under the proposed regime, profits derived by ship agents, ship managers and ship brokers in Hong Kong can enjoy a profits tax exemption or a concessionary profits tax rate of 0% or 8.25% if the specified conditions are met. Subject to the completion of the legislative process, the tax concessions will apply from 1 April 2022.

The Inland Revenue (Amendment) (Tax Concessions for Certain Shipping-related Activities) Bill 2022 (the Bill)[1] was gazetted on 2 June 2022. The Bill seeks to introduce a concessionary tax regime for profits derived from qualifying ship agency, ship management and ship broking activities (i.e. qualifying shipping-related activities) in Hong Kong, subject to fulfilment of the specified conditions. The key features of the proposed tax regime are summarised below.

The proposed tax regime

The tax concessions

Tax concession	Profits eligible for the concessionary tax rates / tax exemption
0% tax rate	• Profits derived from qualifying shipping-related activities carried out for an associated ship lessor or ship leasing manager in respect of its activities that generate income entitled to the 0% tax rate under the existing ship leasing tax regime
8.25% tax rate	• Profits derived from qualifying shipping-related activities carried out for an associated ship leasing manager in respect of its activities that generate income entitled to the 8.25% tax rate under the existing ship leasing tax regime

1 The bill can be accessed via this link: https://www.gld.gov.hk/egazette/pdf/20222622/es32022262215.pdf

Tax concession	Profits eligible for the concessionary tax rates / tax exemption
8.25% tax rate	• Profits derived from qualifying shipping-related activities carried out for an associated shipping principal (e.g. ship lessor or ship leasing manager) that is subject to the 16.5% tax rate[2] • Profits derived from qualifying shipping-related activities carried out for an unrelated shipping principal
Tax exemption	• Profits derived from qualifying shipping-related activities carried out for a connected ship operator in respect of its ship operation activities that generate income entitled to a tax exemption under section 23B of the Inland Revenue Ordinance (IRO)

The qualifying criteria

1. The entity based approach

   - The ship agent, ship manager or ship broker has to be a standalone corporation pre-dominantly carrying out the qualifying shipping-related activities in Hong Kong, subject to the safe harbor rules discussed below.
   - The minimum numbers of qualifying shipping-related activities that need to be carried out for a year of assessment (YOA) are as follows:
     - for ship agents – at least one qualifying ship agency activity;
     - for ship managers – at least two qualifying ship management activities; and
     - for ship brokers – at least one qualifying ship broking activity.
   - Under the safe harbor rules, the ship agent, ship manager or ship broker is allowed to engage in non-qualifying activities provided that (1) the amount of its profits derived from the qualifying shipping-related activities is not lower than 75% of the total profits accrued to the corporation during the basis period and (2) the value of its assets used to carry out the qualifying shipping-related activities is not lower than 75% of the total value of all assets of the corporation as at the end of the basis period:
     - for the subject YOA (i.e. the 1-year safe harbor); or
     - for the subject YOA and the preceding one or two YOAs on an average basis (i.e. the multiple-year safe harbor).
   - The Commissioner of Inland Revenue may, on application by a corporation, determine that it is a qualifying ship agent, qualifying ship manager or qualifying ship broker for a YOA even though the corporation does not satisfy the minimum number of qualifying activities requirement or the safe harbor rules discussed above.

2. The central management and control (CMC) requirement

   The ship agent, ship manager or ship broker has to exercise its CMC in Hong Kong.

3. The substantial activity requirements

   - The ship agent, ship manager or ship broker has to meet the following minimum threshold requirements: (1) to employ at least 1 full-time qualified employee and (2) to incur at least HK$1 million of annual operating expenditure for carrying out the core income generating activities (CIGAs) in Hong Kong.
   - The CIGAs can be outsourced to a group company and in such case, the employees of and the operating expenditure incurred by a group company would be taken into account if certain conditions are met (e.g. an arm's length service fee is charged by the group company and the ship agent, ship manager or ship broker has exercised adequate monitoring of the CIGAs carried out by the group company)[3].
   - The qualifying activities have to be carried out by the ship agent, ship manager or ship broker in Hong Kong or arranged by it to be carried out in Hong Kong.

2 Please however refer to the anti-tax arbitrage rule discussed on the next page.

3 For more details, please refer to the Legislative Council Brief in this link: https://www.legco.gov.hk/yr2022/english/brief/thbtpml91762_20220601-e.pdf

The anti-avoidance provisions

1. The main purposes test

   The proposed tax concessions would not apply if the main purpose, or one of the main purposes, of an arrangement entered into by the ship agent, ship manager or ship broker is to obtain a tax benefit under the IRO or a tax treaty.

2. The anti-tax arbitrage rule

   The tax deduction for service fees paid by an entity that is subject to the full profits tax rate (16.5%) to a connected qualifying ship agent, ship manager or ship broker that is subject to the 8.25% rate would be reduced by reference to the amount of tax saving obtained by the service fee recipient.

3. The arm's length principle

   Transactions entered into between a qualifying ship agent, ship manager or ship broker and its associates in connection with the qualifying activities that are not on an arm's length basis would be subject to transfer pricing adjustments.

KPMG observations

We welcome the proposed concessionary tax regime for various high-value added maritime services in Hong Kong. It would help developing a more vibrant maritime ecosystem in Hong Kong and consolidating Hong Kong's position as an international maritime centre, which is in line with the economic development strategies for Hong Kong as set out in the 14th National Five-Year Plan of the PRC.

Currently, Singapore also offers various tax incentives for the maritime sector under the Maritime Sector Incentive (MSI) Scheme. In particular, the Shipping-related Support Services (SSS) Award under the MSI Scheme offers a 10% concessionary tax rate on the incremental income derived from qualifying approved shipping-related support services for a 5-year renewal period[4]. Services that are eligible for the MSI-SSS Award include ship broking, ship management, ship agency, freight forwarding and logistics services and corporate services provided to certain related entities engaged in shipping business. Application for the MSI-SSS Award is subject to assessment, approval and renewal of the Maritime and Port Authority of Singapore. In addition, an applicant has to meet the minimum professional headcount and business spending requirements, namely at least 5 professional headcounts and total business spending of at least S$6 million on an incremental basis[5]. Tax concessions are also available for ship and container leasing income for up to 5 years under the MSI-Maritime Leasing Award if the specified conditions are met[4].

The proposed concessionary tax regime for maritime services in Hong Kong is competitive in terms of the tax rate, the minimum substance requirement and the fact that the tax concessions are not subject to pre-approval or renewal requirement. We look forward to the swift implementation of the regime and more importantly, the effective administration of the regime that provides clarity and certainty to maritime players and investors. We also urge the government to conduct a periodic review of the effectiveness of the regime and consider expanding the tax concession to a wider range of shipping-related support activities such as container leasing and international freight and logistics operations.

4 For more details, please refer to this link: Maritime Sector Incentive | Maritime & Port Authority of Singapore (MPA)

5 For the minimum commitments under the MSI Scheme, please refer to this link: https://www.mpa.gov.sg/docs/mpalibraries/mpa-documents-files/business-capability-development-division/faq-msi-on-minimum-commitments-under-msi.pdf

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