



ELIGIBLE FOR SHIP LEASING TAX CONCESSIONS IN HONG KONG? CHECK HERE.

On 19 June 2020, the Inland Revenue (Amendment) (Ship Leasing Tax Concessions) Ordinance 2020¹ introduced a concessionary profit tax regime for ship leasing businesses. While the scheme is now more familiar, it is not without its complexities. Are you clear on if/how you can benefit? This article aims to provide some practical assistance by setting out various questionnaires to guide an interested corporation.

¹ <https://www.elegislation.gov.hk/hk/2020/5/en>
<https://www.thb.gov.hk/eng/psp/pressreleases/transport/maritime/2020/20200619a.htm>

What has happened?

The Inland Revenue (Amendment) (Ship Leasing Tax Concessions) Ordinance 2020 amends the Inland Revenue Ordinance (Cap.112) (**IRO**) to establish a concessionary profit tax regime for ship lessors and ship leasing managers in Hong Kong. This new tax regime applies with retrospective effect on profits received or accrued after 1 April 2020.

What are the benefits?

Qualifying ship lessors (**QSLs**) are exempted from paying profits tax on qualifying profits. For qualifying ship leasing managers (**QSLMs**), they may get exempted or be entitled to pay profits tax on qualifying profits at a substantially reduced rate.

At a glance:

- Tax exemption for ship leasing activities (**0% profit tax**²) carried out in Hong Kong by a QSL (including sale and leaseback arrangements and subleasing)
- Tax exemption for ship leasing management activities (**0% profit tax**) carried out in Hong Kong³ by a QSLM for a QSL associated with the QSLM.
- **Reduced 8.25% profit tax** (i.e. half of the profit tax rate for corporations at 16.5%) for ship leasing management activities carried out in Hong Kong by a QSLM for a QSL not associated with the QSLM.

First question

For any corporation conducting ship leasing or related businesses in Hong Kong (or those intending to do so in Hong Kong), the first question to ask is – do I carry out the relevant activities targeted by the new tax regime?

If you do either the ship leasing or ship leasing management activities, you may benefit under the new tax regime.

Questionnaire 1

Ship leasing:

Do I carry out an activity comprising:

- the leasing of a ship to a ship lessor, leasing manager or operator;
- plus*

- any of:
 - (i) agreeing funding terms in relation to that lease;
 - (ii) identifying and acquiring the ship to be so leased;
 - (iii) setting the terms and duration of that lease;
 - (iv) monitoring or revising any funding or other arrangements in relation to that lease; or
 - (v) managing any risks associated with that lease or an activity mentioned in (i) to (iv)?

Ship leasing management:

Do I carry out any of the following activities:

- managing another person that is a ship lessor;
- establishment or administration of a special purpose entity for owning a ship by that entity;
- providing, or arranging for the provision of, finance in obtaining the ownership of a ship by a special purpose entity wholly or partly owned by that person, or evaluating financial proposals from external financiers in relation to the obtaining of that ownership;
- providing, or arranging for the provision of, a guarantee in respect of a financial or performance obligation as regards the ship leasing business of a special purpose entity wholly or partly owned by the person, or granting security in respect of that business;
- managing leases;
- arranging for the procurement or leasing of ships;
- arranging for the operation, crewing, voyage monitoring, maintenance, repair, certification, insurance, storage, scrapping or modification of ships, or the port agency services or security services for ships;
- arranging for the evaluation, appraisal, provision or inspection of ships or maintenance facilities for ships (including internal audits of ship quality);
- arranging for the assessment of the shipping market conditions;
- marketing of leases;
- providing, or arranging for the provision of, finance in obtaining the ownership of a ship by a shipping enterprise from another person that is a ship lessor;
- providing a residual value guarantee or contingent purchase arrangement;
- providing services in relation to a ship leasing activity for or to another person that is a ship lessor; or
- overseeing the design and construction of newbuild ships?

² Section 14P(1), Schedule 8C

³ Section 14O(5)

Do you qualify to get the benefits?

As to be expected, there are conditions to satisfy in order to benefit from the concessions. You will need to qualify as a business, have qualifying profits and satisfy such other conditions under the IRO (including, among others, sections 14O to 14ZB). Essentially, corporations will need to review their businesses and go through a series of questions to determine if they are eligible.

For a corporation engaging in ship leasing activities (as you have identified by answering the above first question), you shall consider, among others, the questions set out in *Questionnaire 2* opposite.

If you have the same answers as opposite, you may qualify for the concession for a ship lessor under the new tax regime.

If you are engaging in ship leasing management activities (as you have identified by answering the first question), you will consider, among others, the questions set out in *Questionnaire 3* below.

Questionnaire 2

During the relevant period	Guidance Notes	Answer
1 Are you a ship operator?	A ship operator is a person carrying on the business of operating ships as an owner or a charterer for providing services for the carriage by ships of passengers, cargo or mail (excluding dealing in ships or agency business in connection with sea transport).	No
2 Have you carried out any qualifying ship leasing activities (and not any other income generating activities)?	<p>The leasing activities shall be under a funding lease or an operating lease, both as defined under the IRO.</p> <p>The leasing shall be done in the ordinary course of the corporation's business carried on in Hong Kong and the ship is of over 500 gross tonnage and navigating solely or mainly outside the waters of Hong Kong.</p>	Yes
3 Are the activities that produce the qualifying profits carried out by you (or arranged by you to be carried out) in Hong Kong?	<p>Threshold requirements (or substantial activity test): The activities are not considered to be carried out in Hong Kong unless: (a) the average number of full-time employees in Hong Kong who carry out the activity and have the qualifications necessary for doing so is adequate in the opinion of the Commissioner of Inland Revenue and in any event not less than 2; and (b) the total amount of operating expenditure incurred in Hong Kong for the activity is adequate in the opinion of the Commissioner of Inland Revenue and in any event not less than HK\$7,800,000.</p> <p>Outsourcing: It may be possible to satisfy the threshold requirements while outsourcing core income generating activities (CIGAs) subject to satisfying certain conditions. If the relevant conditions are met, the number of the qualified full-time employees employed and the amount of operating expenditure incurred by the group company (to which you outsourced the CIGAs) would be taken into account when determining whether you have met the threshold requirements.</p> <p>Central management: It shall be the case that your central management and control is in Hong Kong and that none of the activities that produce the qualifying profits are carried out by a permanent establishment outside Hong Kong.</p>	Yes

Questionnaire 3

During the relevant period	Guidance Notes	Answer
1 Are you a ship operator?	A ship operator is a person carrying on the business of operating ships as an owner or a charterer for providing services for the carriage by ships of passengers, cargo or mail (excluding dealing in ships or agency business in connection with sea transport).	No
2 Have you carried out any qualifying ship leasing management activities (and not any other income generating activities)?	The ship leasing management activity shall be carried out (i) in the ordinary course of the corporation's business in Hong Kong and (ii) for another corporation being a qualifying ship lessor (i.e. a person not being a ship operator, has carried out in Hong Kong qualifying ship leasing activities and not any other income generating activity). The subject ship shall be leased by the qualifying ship lessor to a ship lessor, ship leasing manager or ship operator when the leasing management activity is carried out.	Yes
3 If you have not satisfied the requirements of qualifying ship leasing management activities in question 2 above, have you satisfied the safe harbour rule or obtained the Commissioner's determination (under section 14V IRO)?	Safe harbour rule: Does the aggregate of your ship leasing management profits amount to not less than 75% of the aggregate amount of all your profits from all sources (whether in Hong Kong or not)? <i>plus</i> Does the aggregate value of your ship leasing management assets amount to not less than 75% of the aggregate value of all your assets (whether in Hong Kong or not)?	Yes
4 Are the activities that produce the qualifying profits carried out by you (or arranged by you to be carried out) in Hong Kong?	Threshold requirements (or substantial activity test): The activities are not considered to be carried out in Hong Kong unless: (a) the average number of full-time employees in Hong Kong who carry out the activity and have the qualifications necessary for doing so is adequate in the opinion of the Commissioner of Inland Revenue and in any event not less than 1; and (b) the total amount of operating expenditure incurred in Hong Kong for the activity is adequate in the opinion of the Commissioner of Inland Revenue and in any event not less than HK\$1,000,000. Outsourcing: It may be possible to satisfy the threshold requirements while outsourcing core income generating activities (CIGAs) subject to satisfying certain conditions. If the relevant conditions are met, the number of the qualified full-time employees employed and the amount of operating expenditure incurred by the group company (to which you outsourced the CIGAs) would be taken into account when determining whether you have met the threshold requirements. Central management: It shall be the case that your central management and control is in Hong Kong and that none of the activities that produce the qualifying profits are carried out by a permanent establishment outside Hong Kong.	Yes



Similarly, if you have answered questionnaire 3 as given, you may qualify for the concession for a ship leasing manager under the new tax regime.

Section 23B IRO and the ship leasing tax concessions

The IRO provisions on ship leasing tax concessions expressly state that they do not apply to ship operators. It is also clear that the ship operators in Hong Kong have traditionally been invoking section 23B of the IRO for the preferential tax treatment thereunder. Nonetheless, as a ship operator's operation will on occasions involve leasing of ships on different terms and for different duration, it is not surprising that corporations engaging in shipping related businesses will be assessing their positions under both regimes. In this regard, the Hong Kong Shipowners Association has sought guidance from the HKSAR Government for its members on the interpretation and scope of the new tax regime. The guidance received identified various factors which the Commissioner of Inland Revenue will consider in determining whether a corporation is a ship operator.

If all or some of your answers are the same as *Questionnaire 4* opposite, the Commissioner of Inland Revenue may consider you as a ship operator.

Questionnaire 4

Ship operator ⁴ ?	Answer
1 Are you a party privy to a contract of carriage (e.g. as evidenced in a bill of lading) or contract of affreightment (e.g. as evidenced in a voyage charter)?	Yes
2 Are your risk profile (e.g. cargo claims, delay risk, non-performance risks, freight rate risk, bunker risk) comparable to that of a carrier of passengers, cargo or mail by sea?	Yes
3 Do you perform functions (e.g. loading, handling, stowage, carriage, custody, care and discharge of such goods) and use assets (e.g. technical operation of a ship) comparable to those of a carrier of passengers, cargo or mail by sea?	Yes
4 Do you engage or employ sea crew for the operation of a ship?	Yes
5 Are you responsible for defraying all or a substantial portion of the expenses of operating the ship (e.g. bunker fuel) for the carriage of passengers, cargo or mail by sea?	Yes

⁴ Factors to consider as reproduced from HKSQA Note Tax Regime for Ship Leasing (17.09.20) Hong Kong Shipowners Association Cir.Ref:A(20)170 18.09.20

It shall also be noted that the ship leasing tax concessions only apply to certain types of leases, namely funding leases or operating leases, as defined in the IRO. *Questionnaire 5* opposite shall help you identify one of these leases.

There are no doubt more questions to be answered. We understand that a guidance note from the Inland Revenue Department is anticipated, which will be welcomed by the industry.

Reference

For the content of the Ordinance and a detailed description of its key features and background, please visit the following government and Legislative Council links:

<https://www.gld.gov.hk/egazette/pdf/20202403/es3202024031.pdf>

https://www.legco.gov.hk/yr19-20/english/bills/brief/b202001171_brf.pdf

<https://www.legco.gov.hk/yr19-20/english/panels/edev/papers/edev20191126cb4-130-5-e.pdf>

Questionnaire 5

	You have a funding lease as defined under the IRO if
Is your lease an arrangement under which a right to use a ship is granted by a person (lessor) to another person (Lessee) for a term exceeding 1 year?	Yes
Is the lease accounted for as a finance lease or loan by the lessor in accordance with the Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants or the International Financial Reporting Standards issued by the International Accounting Standards Board?	Yes
#or#	
Is the present value of the aggregate minimum lease payments (whether or not they are periodic payments and including any sum payable under a residual value guarantee) during the term of the arrangement equal to or more than 80% of the fair market value of the ship?	
#or#	
Is the term of the arrangement equal to or more than 65% of the remaining useful economic life of the ship?	
Is your lease an arrangement under which the property in the ship will or may pass to the lessee, or an associate of the lessee, at the end of its term?	Yes
	You have an operating lease as defined under the IRO if
Do you have a funding lease as defined under the IRO?	No
If your lease is a head lease (i.e. you as owner granting a right to use a ship to another person), is your lease for a term exceeding 1 year?	Yes
#or#	
If your lease is not a head lease, is the head lease for a term exceeding 1 year and you are either the lessee under that head lease or a sub-lessee or any other person deriving the that right under that lessee?	

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