



## Hong Kong tax update

Reported by Patrick Kwong

### **Newfair Holdings Limited v CIR, [2022] HKCFI 1133**

The Court of First Instance (CFI) handed down a favorable decision, *Newfair Holdings Limited v CIR*, on 20 April 2022, which held that booked profits are not subject to Hong Kong profits tax.

The taxpayer, Newfair Holdings Limited (Newfair), is a Hong Kong incorporated company within a group whose principal business was distribution of electronic products in Europe sourced from manufacturers in mainland China. Newfair was interposed between a Dutch group company and the third-party suppliers for Dutch tax mitigation purposes. Newfair is a paper company with no office and employee in Hong Kong. Its only connection with Hong Kong was limited to having a bank account in Hong Kong. All the business operations of Newfair (including the operation of the Hong Kong bank account) were undertaken by the staff of its Dutch group company outside Hong Kong.

The CFI judge overturned the Board of Review's (BOR) decision, holding that Newfair did not carry on a trade or business in Hong Kong and all the commercial operations relevant to the production of the trading profits were performed by Newfair outside Hong Kong. While the tax planning arrangement undertaken by the group prevented a portion of the profits from being charged to tax anywhere, the CFI judge noted that it was not a commercial operation that generated the profits in question.

The decision provides a welcoming clarification that profits tax liabilities are imposed on what a taxpayer has done to earn the profits in question, as opposed to what its role or purpose in Hong Kong is, including its being set up in Hong Kong to mitigate the overseas tax liabilities of a group.

In the context of a trading business, the CFI considered that operating a bank account to settle payments due to suppliers and receive payments from customers would not by itself amount to profit-producing activities. They were incidental acts done after the formation of the profit-generating contracts of purchase and sale and would not generally be relevant for determining the source of trading profits.

The IRD did not further appeal the case to the Court of Appeal. The CFI decision is thus a case law precedent which the IRD is bound to follow if the fact pattern of a taxpayer is substantially identical to that of Newfair. As such, the CFI decision may have a potentially widespread impact on the IRD's current practice of assessing offshore claims.

### **Tax concessions for certain shipping-related activities proposed**

On 15 June 2022, the Inland Revenue (Amendment) (Tax Concessions for Certain Shipping-related Activities) Bill 2022 (the Bill) will be introduced to the Legislative Council for the first and second readings. The Bill seeks to introduce a dedicated tax concession regime offering



tax incentives to qualifying shipping commercial principals, i.e., ship agents, ship managers and ship brokers in Hong Kong.

### Overview of the proposed tax concession regime

Subject to certain anti-avoidance provisions, the proposed tax concession regime provides that:

- (i) qualifying profits of a qualifying shipping commercial principal (i.e., a qualifying ship agent, qualifying ship manager or qualifying ship broker) derived from carrying out a qualifying activity (i.e., a qualifying ship agency activity, qualifying ship management activity or qualifying ship broking activity) in Hong Kong will be taxed at a concessionary tax rate at 8.25% (i.e., half of the normal profits tax rate for corporations at 16.5%); and
- (ii) qualifying profits derived by a qualifying shipping commercial principal from carrying out a qualifying activity for an associated shipping enterprise<sup>1</sup>, which is entitled to a concessionary tax rate or income exemption under the Inland Revenue Ordinance (IRO), will also be subject to the same concessionary tax rate or income exemption as that applicable to the associated shipping enterprise concerned.

### Eligibility to the proposed tax concession regime

Taxpayers must elect in writing if they wish to avail themselves of the above tax concessions. Such an election, once made, is irrevocable for so long as the taxpayers remain as a qualifying shipping commercial principal.

The table below lists out the qualifying requirements for the proposed tax concession regime:

Qualifying requirements	Details
Qualifying shipping commercial principal	<ul style="list-style-type: none"><li>• A qualifying shipping commercial principal must be a standalone corporate entity solely engaging in the relevant qualifying activity; or satisfy the safe harbour rule by having at least 75% of its total profits derived from and total assets used for the relevant qualifying activity.</li><li>• Where the corporation fails to qualify as a qualifying shipping commercial principal on the aforesaid condition, the corporation concerned may nonetheless obtain a determination of the Commissioner of Inland Revenue (CIR). The CIR may determine it as being a qualifying shipping commercial principal if he is satisfied that the otherwise non-qualification of the corporation for the year in question arose not out of the ordinary course of business of the corporation.</li></ul>

<sup>1</sup> An associated shipping enterprise refers to a person who is a ship lessor, ship leasing manager, ship operator or ship owner entitled to tax concessions or exemption under section 14P(1), 14T(1) or 23B of the IRO and (a) over which the qualifying shipping commercial principal has control, (b) which has control over the qualifying shipping commercial principal or (c) which is under the control of the same person as the qualifying shipping commercial principal.



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Minimum number of relevant qualifying activity to be carried out	<ul style="list-style-type: none"><li>For both ship agents and ship brokers, the corporation concerned need to carry out at least one or more relevant qualifying activities for a year of assessment;</li><li>For ship managers, the corporation concerned need to carry out at least two or more relevant qualifying activities for a year of assessment.</li></ul>
Qualifying activity	<ul style="list-style-type: none"><li>A ship agency activity, ship management activity or ship broking activity carried out by a qualifying shipping commercial principal is a qualifying activity if the activity is carried out in the ordinary course of the principal's business carried on in Hong Kong.</li></ul>
Central management and control requirement	A qualifying shipping commercial principal must exercise its central management and control in Hong Kong.
Substantial activities requirement	<p>A qualifying shipping commercial principal must undertake to carry out the core income generating activities in Hong Kong by:</p> <ul style="list-style-type: none"><li>having at least 1 full-time qualified employee in Hong Kong; and</li><li>incurring at least HK\$1 million of annual operating expenditure in Hong Kong.</li></ul> <p>In addition to the above objective minimum threshold figures, the Bill also imposes an overarching requirement that the number of persons employed, and the relevant amounts incurred, are in the opinion of the CIR "adequate".</p>

### Specific anti-avoidance provisions

The Bill contains the following specific anti-avoidance provisions that would operate to:

- reassess a qualifying shipping commercial principal based on the arm's length profits that would have been accrued to it if it did not conduct business transactions with its associated parties on an arm's length basis;
- deny a qualifying shipping commercial principal the above tax concessions if the main purpose, or one of the main purposes, of entering into an arrangement is to obtain a tax benefit under the IRO or a tax treaty; and
- reduce the tax deduction for service fees paid by a payer who is subject to tax at full-rate to its connected qualifying shipping commercial principal who is subject to tax at half-rate by reference to the amount of tax savings obtained by the qualifying shipping commercial principal from the receipt of the service fees.

### Effective date

The proposed tax concessions for qualifying profits of a qualifying shipping commercial principal will apply to sums received or accrued on or after 1 April 2022.

**Commentary [I recall that TIHK news update usually don't have commentary. Please delete if appropriate]**



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We welcome the introduction of the proposed tax concession regime for qualifying shipping commercial principals. The proposal will complement the tax concessions for ship leasing and maritime insurance businesses introduced in mid-2020.

Given that ship agency, ship management and ship broking businesses are important maritime business services supporting international shipping activities, the proposed tax concession regime will help bolster the growth of a vibrant maritime industry cluster in Hong Kong and further consolidate Hong Kong's position as an international maritime center.

The provision of tax incentives is one of the means adopted by other major maritime centers to proactively attract businesses to establish presence in their jurisdictions. For example, under the Maritime Sector Initiative – Shipping-related Support Services (MSI – SSS) Award offered by Singapore, an approved MSI – SSS company will enjoy a concessionary tax rate of 10% on the incremental income derived from the provision of specified qualifying approved shipping-related support services such as ship agency, ship management and ship broking, for a renewable 5-year period.

While the concessionary tax rate of 10% currently offered by Singapore may be less competitive than the 0% or 8.25% rate offered under proposed tax concession regime of Hong Kong, the scope of MSI – SSS Award in Singapore appears to be much wider. For example, the scope of the MSI - SSS Award in Singapore also includes other shipping-related support services such as forward freight agreement trading<sup>2</sup>; freight forwarding and logistic services<sup>3</sup>; and a wider range of corporate services (e.g., legal services; corporate finance advisory services; information technology support services) which are apparently not covered by the proposed tax concession regime of Hong Kong.

As such, we hope that the Government will further consult industry players and explore the desirability of further extending the scope of the proposed tax concession regime of Hong Kong with a view to ensuring that it is competitive vis-à-vis that of Singapore in terms of promoting Hong Kong as an international maritime center in the region.

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<sup>2</sup> "Forward freight agreement trading" means the undertaking of a position under a forward freight agreement trade where such trade is in connection with shipping freight rates.

<sup>3</sup> "Freight forwarding and logistics service" means managing a customer's freight, supply chain or logistics process flow.