

Hong Kong Tax Alert

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Hong Kong launches consultation on proposed enhancements to corporate treasury centre (CTC) tax concessions

The consultation seeks views on introducing a new two-tier framework designed to attract more multinational groups to establish treasury operations in Hong Kong and enable existing CTCs to expand their activities.

Key enhancements include:

Tier 1 – Refine and broaden existing regime

- *Deferral of interest expenses*
- *Expansion of scope of interest expenses deduction to cover other corporate treasury activities*
- *Specification of substantial activity requirement*
- *Clarification of benchmark of intra-group financing business*
- *Clarification of definition of “corporate treasury transactions”*

Tier 2 – Introduce an opt-in pre-approval mechanism

- *Removal of “dedicated CTC condition” or the “safe harbour rule”*
- *50% exemption for interest income earned by pre-approved Hong Kong associated corporations*
- *Relaxation of “subject to tax condition” for pre-approved qualifying CTCs (QCTCs)*
- *Relaxation of anti-tax arbitrage rule*
- *Pre-approval conditions*

Clients who are interested in the proposed enhancements should contact their tax executives.

Background

The CTC tax concessions were introduced in 2016. Under the existing regime, QCTCs may benefit from a concessionary profits tax rate of 8.25% on qualifying corporate treasury activities, while corporations carrying on intra-group financing business are able to claim tax deductions for interest expenses paid to overseas associated corporations subject to specified conditions.

Although the regime has contributed to an increase in the number of CTCs established in Hong Kong over the past decade, the Government notes that market participants continue to encounter practical challenges when applying the rules. According to the consultation paper, concerns have been raised regarding the strict qualifying conditions applicable to QCTCs, the operation of the anti-tax arbitrage rule and the “subject to tax” requirement for interest deductions, and the taxation of interest income received by Hong Kong group companies from CTCs. These issues have been identified as factors that may reduce the attractiveness of Hong Kong as a treasury hub when compared with competing jurisdictions.

Proposed two-tier framework

To address these concerns, the Government proposes the introduction of a new two-tier framework comprising enhancements to the existing regime (Tier 1) and a new pre-approval regime (Tier 2) offering additional tax benefits and administrative flexibilities.

Tier 1

Under Tier 1, the existing concessionary framework would remain in place but would be supplemented by a number of targeted refinements.

Deferral of interest expenses

As noted in the consultation paper, corporations that conduct intra-group financing business in Hong Kong often encounter difficulties in meeting the “subject to tax condition” specified in section 16(2)(g) of the Inland Revenue Ordinance (IRO). The existing “subject to tax condition” requires that the lender (i.e. the non-Hong Kong associated corporation) in an intra-group financing transaction must, in respect of the interest income, be subject to tax similar to Hong Kong’s profits tax in a territory outside Hong Kong at a rate not lower than the reference rate in Hong Kong. In particular, the lender must pay tax in that jurisdiction for the taxable period in which the transaction occurs (i.e. the “cash tax requirement”).

Under the proposed enhancement, if the lender does not meet the “cash tax requirement” (e.g. due to tax losses during the taxable period), the CTC will be allowed to defer its tax deduction for interest expenses paid or payable to the lender until the latter begins paying tax, provided that the interest was included in its taxable income in the prior year when the tax loss was sustained. The allowable deduction will be equal to the amount of actual tax paid by the lender divided by the applicable tax rate (capped at the cumulative amount of the CTC’s unclaimed interest expenses paid to that lender in previous years of assessment).

Expansion of scope of interest expenses deduction

It is proposed that the scope of deductible interest expenses be expanded beyond intra-group financing business to cover a broader range of corporate treasury activities. Specifically, interest expenses paid or payable by a CTC to its non-Hong Kong associated corporations would also be deductible where the borrowed funds are used for providing corporate treasury services (such as cash forecasting and cash pooling) or for entering into corporate treasury transactions (such as investing surplus funds of associated corporations in financial instruments). This enhancement is intended to better align the tax concessions with the wider range of treasury activities commonly undertaken by CTCs and to provide greater flexibility for multinational groups in structuring their treasury operations.

Specification of substantial activity requirement

The consultation paper also proposes clarifying the substantial activity requirement under the existing QCTC regime. In particular, the Government proposes specifying that a QCTC should employ at least two professional staff members for conducting corporate treasury activities and incur annual operating expenditure of at least HK\$2 million in Hong Kong in relation to such activities. The proposal seeks to provide greater certainty for taxpayers when assessing whether sufficient economic substance has been established.

Clarification of benchmark of intra-group financing business

Under the current Departmental Interpretation and Practice Notes No. 52 (DIPN 52), the Inland Revenue Department generally accepts that a corporation is carrying on an intra-group financing business if certain transaction benchmarks are met. The consultation paper clarifies that these benchmarks serve only as guidance and should not be regarded as strict qualification requirements. The Government is considering either revising the benchmark to require an **average** of four borrowing or lending transactions each month, or removing the numerical benchmark altogether and assessing each case based on its specific facts and circumstances. Additional examples are expected to be provided to illustrate how the rules would apply in practice, including in industries where borrowing and lending activities may not occur on a regular monthly basis.

Clarification of definition of “corporate treasury transactions”

The consultation paper also proposes clarifying the meaning of “corporate treasury transactions”, particularly the requirement that transactions be entered into “on its own account and related to the business of an associated corporation”. The Government explains that this requirement is intended to ensure that qualifying transactions are connected with the business operations of the CTC group and not unrelated third-party activities. The consultation paper further confirms that in-house factoring arrangements would generally fall within the scope of qualifying corporate treasury transactions, with additional guidance to be included in DIPN 52.

Tier 2

Removal of “dedicated CTC condition” and “safe harbour rule”

A key feature of the proposed pre-approval regime is the removal of the current “dedicated CTC condition” and “safe harbour rule”. Under the existing regime, a concessionary tax rate is generally available only if the entity operates solely as a CTC or satisfies prescribed safe harbour thresholds. Under the proposal, pre-approved QCTCs would no longer need to satisfy these requirements, provided that certain operational safeguards are maintained. These include requirements to maintain separate bank accounts and separate financial statements for CTC business and non-CTC business. These separate financial statements can either be audited or certified by the corporation.

In addition, the consultation paper proposes replacing the existing central management and control requirement with the less restrictive requirement that normal management or control of the business be exercised in Hong Kong.

50% exemption for interest income earned by pre-approved Hong Kong associated corporations

The consultation paper further proposes that a pre-approved Hong Kong associated corporation be entitled to a profits tax exemption on 50% of the interest income derived from a pre-approved QCTC.

Relaxation of “subject to tax condition” for pre-approved QCTCs

Under the proposed enhancements, pre-approved QCTCs will no longer be required to satisfy the existing “subject to tax condition” when claiming deductions for interest expenses paid or payable to non-Hong Kong associated corporations.

Relaxation of anti-tax arbitrage rule

The anti-arbitrage rule requires a corresponding reduction in the tax-deductible amount of a payment made by an associated corporation that is subject to profits tax in Hong Kong at the normal rate, if the payment in the hands of the CTC is subject to the concessionary tax rate.

The Government proposes that pre-approved Hong Kong associated corporations would no longer be subject to the existing anti-tax arbitrage rule. Instead, full deductions would generally be available for expenses paid or payable to a pre-approved QCTC, with interest deductions subject to a cap equal to 30% of its earnings before interest, taxes, depreciation, and amortisation (EBITDA).

Pre-approval conditions

Under the proposed regime, pre-approval would be granted for a five-year period, subject to renewal upon satisfying a set of objective conditions to be maintained throughout the incentive period, including:

- A minimum annual group turnover of HK\$100 million
- Provision of corporate treasury activities to at least six associated corporations (including at least one non-Hong Kong associated corporation)
- Annual operating expenditure of at least HK\$4 million in Hong Kong (increasing by an additional HK\$1 million in the year preceding renewal)
- Employment of at least two professional staff (increasing by one additional professional in the year preceding renewal)
- Maintenance of separate bank accounts and (audited or certified) financial statements for CTC business and non-CTC business
- Maintenance of a primary bank account with a Hong Kong authorized institution

Pre-approval may also be granted on an exceptional basis where a CTC or group is unable to satisfy all the above objective conditions but is considered to possess strong growth potential, significant strategic value, or substantial expected economic contributions to Hong Kong. Relevant considerations may include the group's commitment to Hong Kong, anticipated business growth, and the scale of its proposed treasury operations.

Our observations

We welcome the Government's proposed enhancements to the CTC regime. Many of the proposals directly address issues that have been raised by taxpayers and industry stakeholders over the years, particularly in relation to restrictive qualifying conditions, the "subject to tax condition", and anti-tax arbitrage provisions.

The introduction of the pre-approval regime is particularly noteworthy. By providing tax certainty and enhanced benefits to groups that establish substantial treasury activities in Hong Kong, the proposal reflects the Government's clear intention to boost Hong Kong's competitiveness as a regional and global treasury hub.

One of the key enhancements under the proposed Tier 2 regime is the replacement of the existing "central management and control" requirement with a "normal management or control" requirement. This is expected to provide greater operational flexibility and align more closely with commercial treasury models adopted by multinational groups. Given that many of the practical issues associated with central management and control are equally relevant to taxpayers operating under the existing concession regime, the Government may consider whether a similar relaxation should also be extended to Tier 1 taxpayers. Extending this more flexible management test across the entire regime could further enhance Hong Kong's attractiveness as a treasury hub while preserving underlying substance requirements.

Multinational enterprise (MNE) groups within the scope of the OECD Pillar Two global minimum tax rules may also wish to assess the interaction between the proposed enhancements and their Pillar Two profiles. While the consultation paper focuses primarily on the domestic tax treatment of treasury activities, the effective benefit of the proposed tax concessions may differ depending on the group's overall effective tax rate (ETR) in Hong Kong. In particular, these MNE groups should evaluate whether the proposed tax concessions would result in a reduction of their jurisdictional ETR in Hong Kong and whether any resulting tax benefit could be offset through top-up tax rules.

The Government may also consider whether to incorporate additional Pillar Two-compatible incentive features in the proposed enhancements to preserve the effectiveness of the regime for large MNE groups that are subject to the top-up tax rules. For example, tax incentives could be granted based on expenditures incurred rather than income derived such that the incentives qualify for the favourable tax treatment under the Pillar Two rules as qualified tax incentives.

The proposed objective conditions for pre-approval provide welcome certainty and demonstrate the Government's intention to target enhanced concessions at groups with substantial treasury activities in Hong Kong. Nevertheless, the Government may wish to consider whether certain thresholds - including the minimum annual operating expenditure of HK\$4 million, the requirement to serve at least six associated corporations, and the HK\$100 million turnover threshold - are appropriately calibrated across different industry sectors and business models.

That said, the consultation paper indicates that there will be a degree of flexibility by allowing pre-approval to be granted on an exceptional basis. This flexibility is a positive feature of the proposed regime and may help accommodate high-growth businesses or groups in the process of scaling up their treasury operations in Hong Kong. Presumably, such flexibility would also apply to CTCs seeking renewal of the tax concessions.

Overall, the consultation paper reflects the Government's continued commitment to strengthening Hong Kong's position as an international treasury hub. The proposed measures address a number of long-standing concerns under the existing regime and represent a positive step towards enhancing Hong Kong's competitiveness in an increasingly complex and evolving international tax landscape.

Clients who are interested in the proposed enhancements should contact their tax executives.



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