

Hong Kong Tax Alert

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Advance Ruling Case No. 76¹ - what constitutes assessable profits derived from "intra-group lending transactions" of a qualifying corporate treasury center (QCTC)

- it may be reasonable to assume in this case that the applicant will, apart from the borrowing from external financial institutions for on-lending to its associated corporations, also have other borrowing of money from and lending of money to its associated corporations as a business. Otherwise, the applicant may not be regarded as carrying on an intra-group financing business and, if so, the interest income from the on-lending would not be eligible for the 8.25% concessionary tax rate.*

In any case, what constitutes an "intra-group financing business" on account of the frequency, scale and regularity, etc. of the intra-group borrowing and lending activities of a person would still be fact specific.

Clients who wish to explore their eligibility for the preferential tax regime for QCTCs can contact their tax executive.

¹ The Advance Ruling Case No. 76 can be accessed from the link below:

<https://www.ird.gov.hk/eng/ppr/advance76.htm>

Profits derived from “intra-group lending transactions” eligible for the half-rate tax concession

The law

Under section 14D(1)(a) of the Inland Revenue Ordinance (IRO), the assessable profits derived by a QCTC from its “intra-group lending transaction” will, on election, be chargeable to profits tax at the concessionary tax rate of 8.25%, i.e. at half of the normal corporate tax rate of 16.5% in Hong Kong.

The term “intra-group lending transaction” is defined in section 14C of the IRO to mean, in relation to a corporation, “a transaction under which the corporation lends money, in the ordinary course of its **intra-group financing business**, to its associated corporations”. (Our emphasis)

The term “intra-group financing business” is in turn defined to mean in relation to a corporation “the business of borrowing of money from and lending of money to its associated corporations”.

Thus, it would appear that to constitute an “intra-group lending transaction”, all the following conditions would need to be satisfied:

- (i) the money is lent by the QCTC to its associated corporations;
- (ii) the money so lent is borrowed by the QCTC from its associated corporations;
- (iii) the above borrowing and lending transactions undertaken by the QCTC constitute an intra-group financing business carried on by the QCTC on account of their frequency, scale and regularity, etc.; and
- (iv) the money is lent in the ordinary course of that intra-group financing business.

As such, strictly interpreted, the borrowing of money by a QCTC from external financial institutions for on-lending to its associated corporations may therefore not qualify as an “intra-group lending transaction”. If so, interest derived by the QCTC from such on-lending would not qualify for the half-rate tax concession.

The practice

Paragraphs 9 and 10 of the Departmental Interpretation and Practice Notes No. 52 - Taxation of Corporate Treasury Activity (DIPN 52) issued by the Inland Revenue Department state that:

“...Whether a corporation is carrying on an intra-group financing business is a question of fact... Regard shall be had to all the relevant factors, including:

- (a) *the frequency, repetitiveness and the amount of the borrowing from and lending to associated corporations of money;*
- (b) *whether there is borrowing from and lending to associated corporations of money at commercial rates of interest;*
- (c) *whether there is a degree of system and continuity of laying out and getting back of the loan of money by way of interest and repayment of principal;*
- (d) *the regularity and frequency of the payment of interest and repayment of principal;*
- (e) *whether a profit is earned out of the interest differential between the borrowing and lending; and*
- (f) *whether the interest charged on the borrowing and lending is on an arm's length basis.*

To constitute an intra-group financing business, there must be a sufficient number of intra-group borrowing and lending transactions with a number of associated corporations, involving not an insignificant amount of funds having regard to the nature and scale of the business operations of the multinational corporation. The intra-group financing business can rely on funding through various sources (e.g. bank finance or equity)...” (Our emphasis)

Thus, the term “intra-group financing business” appears to have been liberally interpreted in practice as including a QCTC borrowing money from a third-party bank for on-lending to its associated corporations. This would be the case provided that the QCTC has, apart from the bank borrowing, also undertaken as a business a sufficient number of intra-group borrowing and lending transactions.

In other words, the on-lending of money borrowed by the QCTC from the bank to its associated corporations can supplement its own “intra-group financing business”, the supplemental part then becoming an inseparable and integral part of that intra-group financing business as a whole.

As such, interest derived from such on-lending in situations similar to the above by a QCTC would still be regarded as its assessable profits derived from an "intra-group lending transaction" eligible for the concessionary tax rate.

Advance Ruling Case No. 76

The facts stated in the ruling case of an applicant in relation to the "assessable profits derived from its intra-group lending transactions" eligible for the 8.25% concessionary tax rate are as follows:

Inter-company lending and borrowing activities

- (1) Lending money to the associated companies – discussing, reviewing and approving funding requests; approving and signing loan agreements; remitting funds to the associated companies; monitoring the receipt of interest income; and
- (2) Borrowing money from external financial institutions – discussing and approving external funding decisions; negotiating with financial institutions; approving borrowing terms and loan agreements; signing loan agreements.

The facts of the case as stated above do not explicitly indicate whether the applicant, apart from the on-lending of money borrowed from external financial institutions to its associated corporations, will also have other borrowing of money from and lending of money to its associated corporations as a business.

Nonetheless, given that both the law and the assessing practice stated in DIPN 52 discussed above have not been amended, it may be reasonable to assume that the ruling is granted on the premises that there will also be a sufficient number of such intra-group borrowing and lending transactions undertaken by the applicant as a business.

In any case, what constitutes an "intra-group financing business" on account of the frequency, scale and regularity, etc. of the intra-group borrowing and lending activities of a person would still be fact specific. Clients who wish to explore their eligibility for the preferential tax regime for QCTCs can contact their tax executive.



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