

Hong Kong introduces tax concessions for ship lessors and ship leasing managers

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Executive summary

The Hong Kong Government introduced the Inland Revenue (Amendment) (Ship Leasing Tax Concessions) Bill 2020 (the Bill) on 17 January 2020. The Bill proposes a tax regime offering tax incentives to qualifying ship lessors and qualifying ship leasing managers in Hong Kong.

The provisions of the Bill will apply for income received or accrued on or after 1 April 2020.

This Alert summarizes the key provision of the tax regime.

Detailed discussion

The proposed tax regime provides:

1. The tax rate on the qualifying profits of qualifying ship lessors derived from a qualifying ship leasing activity will be 0%.
 - ▶ A corporation is deemed a "qualifying ship lessor" if it is: (i) not itself a ship operator; and (ii) solely dedicated to carrying out in Hong Kong one or more of the qualifying ship leasing activities.
 - ▶ "Qualifying profits of a qualifying ship lessor" refer to profits derived in the ordinary course of the business of the lessor in Hong Kong from the leasing of a ship, which is: (i) of over 500 gross tonnage; and

(ii) navigating solely or mainly outside the waters of Hong Kong, to a ship lessor, a ship leasing manager or a ship operator. The lease could be in the form of an operating lease or a finance lease.

- ▶ “Qualifying ship leasing activity” is broadly defined to include leasing of a ship to a ship lessor, a ship leasing manager or a ship operator. Sub-leasing and finance lease arrangements (including that in the form of a sale-and-leaseback arrangement) would also qualify for the tax concessions.
2. The tax rate on the qualifying profits of qualifying ship leasing managers carrying out qualifying ship leasing management activities for a non-associated qualifying ship lessor will be 8.25%. The tax rate will be reduced to 0% if the qualifying ship lessor is an associated corporation.
 - ▶ Subject to certain safe harbor rules,¹ a corporation qualifies as a “qualifying ship leasing manager” if it is: (i) not itself a ship operator; and (ii) solely dedicated to carrying out in Hong Kong one or more of the qualifying ship leasing management activities.
 - ▶ “Qualifying profits of a qualifying ship leasing manager” refer to profits derived by the manager from performing ship leasing management activities for a qualifying ship lessor in the ordinary course of the business of the manager in Hong Kong.
 3. The deemed taxable amount in respect of the qualifying ship leasing income of a qualifying ship owner-lessor derived from an operating lease will be equal to 20% of rental income reduced by deductible expenses (excluding depreciation).
 4. The taxable amount in respect of income derived from a finance lease by a qualifying ship lessor will be equal to the relevant finance charges or interest received from the lease reduced by deductible expenses.

Additional conditions to be satisfied for the application of the concessionary tax rates

In addition to the above, a qualifying ship lessor or a qualifying ship leasing manager must satisfy the following specified conditions in order to avail themselves of the proposed dedicated tax regime:

1. The central management and control of the lessor or manager must be exercised in Hong Kong.
2. The activities that produce the qualifying profits in that year must be either: (i) carried out in Hong Kong by the lessor or manager themselves; or (ii) arranged by the lessor or manager to be carried out in Hong Kong.²
3. The aforesaid activities are not carried out by a permanent establishment located outside of Hong Kong.

Ships held at least three years to be treated as capital assets

The Bill specifies that a ship owned by a qualifying ship lessor is to be treated as a capital asset of the lessor, for the purpose of profits tax in Hong Kong, if the lessor: (i) has used the ship for carrying out a qualifying ship leasing activity for a continuous period of not less than three years immediately before the lessor disposes of the ship; and (ii) the above tax concessions apply in respect of the leasing of the ship for all relevant taxable years.

Therefore, given that Hong Kong does not tax capital gains, a qualifying ship lessor satisfying the above conditions would not be liable to Hong Kong profits tax in respect of gains derived from the disposal of the ship.

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