

Hong Kong provides clarifications for the concessionary tax regime for qualifying ship leasing activities

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The Hong Kong Inland Revenue Department issued Departmental Interpretation and Practice Note 62 (DIPN 62)¹ clarifying the provisions of the new law² that grants concessionary tax treatment for (i) qualifying ship lessors and (ii) qualifying ship leasing managers in Hong Kong.

This Alert summarizes the key provisions of DIPN 62.

Summary of tax concessions and eligibility

- ▶ The tax rate on the qualifying profits of qualifying ship lessors³ derived from a qualifying ship leasing activity⁴ is 0%.
- ▶ The tax rate on the qualifying profits of qualifying ship leasing managers⁵ carrying out qualifying ship leasing management activities for a non-associated qualifying ship lessor is 8.25%. The tax rate is reduced to 0% if the qualifying ship lessor is an associated corporation.
- ▶ To be eligible for the concessionary tax regime, the following minimum requirements must be met. However, such minimum requirements are only pre-requisite requirements. The Hong Kong Tax Authority will also consider if the actual amount of operating expenditure incurred, and the number of qualified persons employed, are adequate.

Qualifying activities	Average number of full-time qualified persons employed in Hong Kong	Annual operating expenditure incurred in Hong Kong
Ship leasing	Two	HK\$7.8 million (US\$1 million)
Ship leasing management	One	HK\$1 million (US\$130,000)

- Where a corporation is not dedicated solely to undertaking ship leasing management activities, it must pass one of the prescribed safe harbor rules to qualify for the concessionary tax treatment. One of the prescribed safe harbor rules requires both the aggregate amount of the ship leasing management profits (SLMP) and the aggregate value of the ship leasing management assets (SLMA) for a tax year to be not less than 75% of the total amount of the profits and value of the assets of the corporation concerned.

Clarifications provided by DIPN 62

- DIPN 62 clarifies that the following activities also fall within the scope of the “ship leasing management activities of a ship leasing manager”:
 - The manager’s own leasing of a ship from a ship owner and sub-leasing the ship to another person.
 - Provision or arrangement for the provision of: (i) finance in obtaining the ownership of a ship; or (ii) a guarantee in respect of financial or performance obligations regarding the ship leasing business as a special purpose entity which is wholly or partially owned by the manager or an associate of the manager.
 - At the request of a qualifying ship lessor, the manager providing finance to a ship operator to acquire a ship from the qualifying ship lessor, regardless of whether the ship operator or the qualifying ship lessor are associated with the manager.
- As explained above, the Hong Kong Tax Authority would also consider if the actual amount of operating expenditure incurred, and the number of qualified persons employed, are adequate. However, the term “adequate” is not defined in the new law.
 - DIPN 62 indicates that if a comparison was made to a taxpayer in a similar position and the amount of profits claimed under the tax concession is disproportionate to the number of qualified persons employed and the amount of operating expenditure incurred, the Hong Kong Tax Authority may presume that the “adequacy test” is not met. However, the taxpayer may provide relevant evidence to show that notwithstanding the disproportionality, the required core income generating activities are in fact carried out in Hong Kong.
- Regarding the safe harbor rules, DIPN 62 states that:
 - In general, the accounting profits and asset values as reflected in the audited financial statements of a corporation will be relevant, regardless of the source of the profits and location of the assets concerned.
 - Where an asset which is used partly for carrying out a qualifying ship leasing management activity and partly for another purpose, apportionment of the value of the asset concerned by reference to the extent of the two respective uses would be required in determining the SLMA of a ship leasing manager.
 - In the case where a ship leasing manager also acts as the holding company for a leasing group, both equity investments in group companies and dividend income from the denominators will be excluded for the calculation of the SLMA and SLMP percentages.

Endnotes

1. Released on 7 December 2020.
2. See EY Global Tax Alert, [Hong Kong enacts tax concession legislation for ship lessors and ship leasing managers](#), dated 15 July 2020.
3. 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.
4. “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.
5. 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.

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