Hong Kong drives to become a Corporate Treasury hub with new policies and incentives

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Asia has gained increased importance on the world stage as international companies look to establish footprints in the region, and in more recent times, Asian companies, in particular Chinese State-owned Enterprises (SOEs) and Privately-owned Enterprises (POEs), expand their businesses overseas. Mainland SOEs and POEs are particularly encouraged by the Chinese Central Government’s policies of “One Belt, One Road”, further liberalisation of capital account, and internationalisation of the RMB.

Corporate treasury plays an extremely important role to support these expansions, and in particular, the use of a corporate treasury centre (“CTC”), if designed and implemented properly, could bring great benefits to corporates. Hong Kong has been one of the premier locations of choice for regional CTCs; however, Hong Kong’s attractiveness in recent years has been hindered by certain unintended taxation consequences, but there is good news on the way with the recent changes announced in the 2015/16 budget.
The Good News

In the 2015-16 Budget, the Financial Secretary announced that the Hong Kong Government plans to amend the Inland Revenue Ordinance to:

- Allow, under specified conditions, interest deductions under profits tax for CTCs and
- Reduce profits tax for specified treasury activities by 50% (i.e. to 8.25%).

The first amendment essentially corrects for a previously unintended tax consequences of asymmetrical taxation on inter-company interest. Under the proposed new rules, interest expenses related to inter-company borrowings will become deductible, under the conditions where interest income received by the corresponding inter-company is subject to tax of similar nature outside of Hong Kong at a rate that is not lower than Hong Kong’s profit tax rate. However, it should also be noted that, this proposed change will also make it clear that interest income from inter-company lending will be deemed trading receipts chargeable to profit tax. This change may impact corporates which have been applying the “provision of credit” test in the past.

The second amendment is intended to be an incentive to encourage corporates to set up their treasury centres in Hong Kong. This is a positive move anticipated by many in the industry to put Hong Kong on equal or better footing from a tax perspective with other popular CTC destinations (e.g. Singapore) where tax incentive schemes have already been in place.

The coverage and definition of the qualifying treasury activities will be important to the industry. An initial draft of the amendment proposed to the Legislative Council in June defined qualifying corporate treasury services and transactions to include the following:

<table>
<thead>
<tr>
<th>Qualifying Corporate Treasury Services</th>
<th>Qualifying Corporate Treasury Transactions</th>
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<tbody>
<tr>
<td>(applicable for services to associated corporations in or outside Hong Kong not being financial institutions)</td>
<td>(applicable for transactions entered into on own account)</td>
</tr>
<tr>
<td>• The management of the cash and liquidity position, including cash forecasting, of the corporate group, and provision of related advice;</td>
<td>• Transactions in relation to the provision of guarantees, performance bonds, standby letters of credit or other similar credit risk instruments in respect of borrowing by associated corporations;</td>
</tr>
<tr>
<td>• The processing of payments to vendors or suppliers of the corporate group;</td>
<td>• Investment in deposits, certificates of deposits and shares of surplus cash for liquidity management;</td>
</tr>
<tr>
<td>• The services in relation to the provision of guarantees, performance bonds, standby letters of credit and services relating to remittances to and on behalf of the corporate group;</td>
<td>• Transactions in the contracts for difference, foreign exchange contracts, futures contracts, options contracts for hedging interest rate risk, foreign exchange risk, liquidity risk or credit risk; and</td>
</tr>
<tr>
<td>• Providing corporate finance advisory services, including activities supporting the raising of capital, either by way of debt or equity, or the provision of services in relation to the raising of capital, for and on behalf of the corporate group;</td>
<td>• Factoring and forfaiting activities.</td>
</tr>
<tr>
<td>• Providing advice and services in relation to the management of interest rate risk, foreign exchange risk, liquidity risk and credit risk; and</td>
<td></td>
</tr>
<tr>
<td>• Providing business planning and co-ordination including economic or investment research and analysis in connection with any of the above activity.</td>
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Initial industry feedback calls for potential expansion to the above list to include activities such as cash pooling, hedging commodity price risk, and investments in equity and bonds. These suggestions will be further discussed during the consultation period.

Another key area that will attract discussion in the initial proposal is around the requirement to file CTC profit through a separately formed legal entity. This setup may be different than existing organisational structure for many corporates where the treasury function is embedded within the legal structure of the corporate entity.

**Timetable for the New Amendments**

- **Feb 2015:** CTC Policy announced
- **May 2015:** Working group to review technical parameters
- **Q3 2015:** Industry Consultation
- **2015/16 legislative session:** Introduction of the Bill to Legislative Council

With the timetable for enactment of the proposed amendments coming as early as the beginning of 2016, corporates are encouraged to review suitability and applicability of the CTC changes to their own treasury functions now, provide comments and suggestions during the consultative period in Q3/Q4 2015, and prepare their own treasury function accordingly in order to take advantage of these amendments.

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**Is CTC Right for your Organisation?**

In addition to tax considerations, there are many factors that should drive the decision on whether a CTC organisation structure can bring value to your organisation. We have highlighted some considerations and potential benefits of CTC as a starting point for assessing suitability and building a business case:

<table>
<thead>
<tr>
<th>Corporate Considerations</th>
<th>Potential CTC Benefits</th>
</tr>
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<tbody>
<tr>
<td>1. Do you have lots of bank accounts at multiple banks in different provinces in China? In different countries?</td>
<td>- CTC facilitates cross-border cash pooling in different currencies. This can be done on a cash basis as well as on a notional basis and, with more flexibility offered by the Chinese regulators recently, it is now possible to pool on- and off-shore cash balances residing among China, Hong Kong, and other countries.</td>
</tr>
<tr>
<td>2. Do you lack visibility and control over the use of cash, for either funding or investments purposes, between headquarter and different overseas locations?</td>
<td>- CTC, with proper process design and system support, can help to centralise financial resources to achieve cost savings on funding and increase investment returns on excess cash. This is especially true for corporates where the parent entity has relatively stronger bargaining power or better credit rating.</td>
</tr>
<tr>
<td>3. Do you incur foreign currency exposures from different investments or business activities that are carried out at your subsidiaries?</td>
<td>- CTC can support the netting of foreign currency exposures across currencies within multiple operating entities thereby giving better visibility to your company’s net exposure and reducing potential hedging costs.</td>
</tr>
<tr>
<td>4. Is your company growing rapidly and management demanding more value and advice from the treasury function?</td>
<td>- CTC acts as a centre of excellence in treasury management by standardising and centralising key treasury functions to a single location. This is a first step towards enhancing the efficiency and effectiveness of treasury functions to transform treasury to become a ‘business partner’ to management.</td>
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Hong Kong as a Premier CTC Location

Several cities in Asia have offered themselves as candidates for CTCs. More mature locations include Hong Kong and Singapore; in recent years, there have also been an increasing number of CTCs being set up in countries such as Japan, Australia and Malaysia. From a tax perspective, Hong Kong has a competitive tax regime; furthermore, Hong Kong does not impose tax on dividends, estates, capital gains, and there are also no withholding tax on interest or dividend payments, sales or VAT taxes. Refer to table on the right for a comparison of various tax rates among Hong Kong, Singapore, and China.

In addition to tax treatments, corporates should consider many other factors when choosing the right CTC location such as:
- proximity to corporate’s underlying businesses;
- availability of talent pool;
- strength of legal framework and structure;
- accessibility to debt capital markets

In the following table, we set out a comparison of some key parameters between two popular CTC locations – Hong Kong and Singapore.

<table>
<thead>
<tr>
<th>Type of tax</th>
<th>Hong Kong</th>
<th>Singapore</th>
<th>Mainland China</th>
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<tbody>
<tr>
<td>(Concessionary) profits tax rate for CTCs</td>
<td>8.25%</td>
<td>10%</td>
<td>25%</td>
</tr>
<tr>
<td>Personal tax rates (maximum)</td>
<td>15%</td>
<td>20%</td>
<td>45%</td>
</tr>
<tr>
<td>Social security (employer)</td>
<td>5% (subject to cap)</td>
<td>17% (subject to cap)</td>
<td>-35% (varies by cities and subject to cap)</td>
</tr>
<tr>
<td>Social security (employee)</td>
<td>5% (subject to cap)</td>
<td>20% (subject to cap)</td>
<td>-10.5% (varies by cities and subject to cap)</td>
</tr>
<tr>
<td>Value added / sales tax</td>
<td>0%</td>
<td>7%</td>
<td>17%</td>
</tr>
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</table>

With a robust financial infrastructure, established legal system, special ties to China, and now anticipated tax incentives, Hong Kong offers unique characteristics and advantages as a CTC location for both multi-national corporations seeking a stronger presence in the region as well as Chinese based companies looking to expand globally.
Key Steps to Set Up a CTC

- Perform treasury review to assess the suitability of CTC
- Determine the global treasury setup best suited to support future business model
- Conduct CTC location feasibility study
- Develop CTC organisation, process, and system design
- Implementation (governance structure, policy, system, staffing, organisation, PMO)

Key Outputs

- Suitability study
- Cost benefit analysis
- Treasury target operating model
- Preliminary CTC service scope and model
- Revised governance structure
- Feasibility report on CTC locations
- Revised organisation structure
- Process design
- Changes to system support (if any)
- Implementation roadmap
- Project plan
- New policies and procedures
- CTC key performance indicators
- System enhancement (if needed)
- Training

PwC Treasury Consulting

PwC is voted Number 1 Treasury Consultant for 14 years running by Treasury Management International. Our China and Hong Kong team is made up of consultants who are seasoned ex-treasurers with knowledge of leading market practices as well as hands-on operations experience. We can guide you through your CTC considerations, take advantage of the potential policy changes, as well as other treasury needs to maximise efficiency and effectiveness of your Treasury function.

Contacts

<table>
<thead>
<tr>
<th>CTC Subject Matter Contacts</th>
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