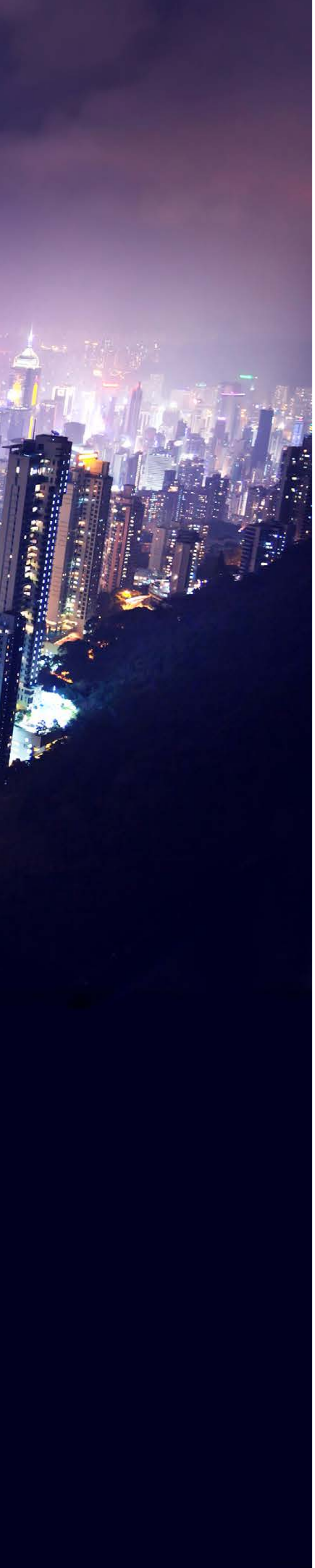
SAFE HARBOUR

RECENT LEGAL AND TAX CHANGES HAVE HELPED HONG KONG TO POSITION ITSELF AS ASIA'S LEADING TREASURY HUB LOCATION, SAYS JAMES BADENACH



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Hong Kong has introduced recent law changes to address the asymmetrical tax treatment of interest income and expense that previously had made it less favourable for regional corporate treasury centres (CTCs). It has also added a half-rate tax incentive with a view to attracting more global and regional CTCs.

Hong Kong is well positioned for corporate groups (both Western multinational corporations (MNCs) and Asian outbounds) to centralise their global and regional treasury functions because of its proximity to mainland China, the largest offshore renminbi pool, well-developed banking system, efficient capital and FX markets, deep talent pool of experienced treasury, banking and asset management personnel, favourable regulatory and tax regime, and sound common law legal system. "The recent tax law changes will make Hong Kong more competitive when global and Asian MNCs look for a location to set up a corporate treasury centre in the Asian time zone," says Vincent Lee, executive director of the Hong Kong Monetary Authority.

There are two key drivers behind the interest in Asia as a base for CTCs. First, the size and scale of Western MNCs in the region have continued to increase as the balance of economic power shifts towards Asia and other emerging markets. "The increased scale of Western MNCs in Asia is resulting in an increased need for the active management of treasury during the Asian time zone and to be closer to the markets to better deal with some of the regulatory and other market inefficiencies that exist in Asia," according to Bonnie Chiu, regional head of sales, global banking corporates, global liquidity and cash management at HSBC.

Second, Asian corporate groups are expanding globally with acquisitions and also maturing in their operations, including their treasury functions. There is a growing recognition and awareness among Asian corporate groups, as they become more global, of the need to centralise the treasury function and the management of cash, to better manage liquidity and reduce funding costs across the corporate group. As these Asian corporate groups obtain better visibility over their cash and debt positions, such considerations invariably turn to the centralisation of the corporate treasury function into a CTC.

According to a recent EY survey of corporate treasurers on global and regional operating models and location selection for CTCs in Asia-Pacific, key factors that corporate groups look into on CTC location selection typically include:

- sophistication of financial infrastructure;
- access to capital markets;
- cost and availability of treasury talent;
- overall tax environment;
- legal and regulatory environment; and
- political stability.

For CTCs actively managing the treasury position (as distinct from service-centre-type CTCs performing, for example, payment processing), aspects such as the legal and regulatory environment, access to capital markets and availability of treasury talent are generally assumed to be a given for a location to be seriously considered for setting up a CTC.

Why Hong Kong?

Without doubt, Hong Kong has its strengths. It ranks as the world's most competitive economy in the *IMD World Competitiveness Yearbook 2016*, moving up from second place in 2015. It also places third globally behind Switzerland and Luxembourg and first in Asia in terms of availability of financial services in the World Economic Forum's *Global Competitive Report 2015-2016*. Hong Kong has high standards of market transparency, disclosure, prudent supervision and is without exchange controls, all crucial for centralised treasury functions.[1]

"While we are seeing a lot of interest in Shanghai for treasury centres focused on managing the treasury position in China, and an onshore cash pool for renminbi, for a regional or global CTC in Asia, the choice invariably comes down to Singapore and Hong Kong," according to E-May Neoh, Asia head of liquidity management, Bank of America Merrill Lynch. "The location of choice is then decided around a corporate group's current geographic footprint and regional headquarters location, together with economic factors, such as taxation."

Hong Kong is one of the most competitive economies worldwide, according to the IMD World Competitiveness Center, and is already a leading destination for regional and international headquarters and CTCs. Based on the *Report on 2015 Annual Survey of Companies in Hong Kong Representing Parent Companies Located outside Hong Kong*, the number of regional headquarters, regional offices and local offices in Hong Kong rose from 6,948

Hong Kong is one of the most competitive economies worldwide, according to the IMD Competitiveness Center in 2011 to 7,904 in 2015.[2] Of these, there is a steady growing rate of set-ups with parent companies located in China.

Hong Kong made its intention clear in the 2014 budget of attracting more CTCs to Hong Kong to enhance its position as a leading global international financial centre, a leading offshore renminbi centre, a premier asset management hub and an international capital market. The Hong Kong government followed through with the passing of legislation that addressed the tax asymmetry issue in the Hong Kong domestic tax law and also legislated a tax rate incentive of 8.25%.

The asymmetry issue previously arose where interest expenses paid to overseas non-financial institutions prior to the law changes were not tax-deductible in Hong Kong for a CTC carrying on the business of lending of money in Hong Kong, while at the same time the interest income from overseas lending was chargeable to tax in Hong Kong. "The law has now been changed to address this issue, albeit with certain conditions," says Alice Chan, partner and international tax services leader at EY Hong Kong. "Our clients are now viewing Hong Kong in a different light in any analysis on location selection for their regional or global CTCs. Now Hong Kong is being seriously considered, which bodes well for Hong Kong, given its geographic advantage of being proximate to mainland China."

In addition, Hong Kong has legislated for a tax rate incentive of 50% of the current profits tax rate (ie 8.25%) for qualifying CTCs in respect of a broad range of prescribed corporate treasury services and transactions. The tax rate incentive is relatively wide in terms of the activities that fall within the incentive, however, to obtain the incentive may require CTCs to set up in a separate legal entity to conduct the treasury activities.

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Tax should never be the sole consideration in choosing the location of a CTC

For regional or global CTCs in Asia-Pacific, Hong Kong and Singapore are generally the preferred locations, and there has been a healthy rivalry between them as global financial centres, with both possessing the relevant attributes for corporate treasurers. Both locations are well positioned as CTC hubs in terms of financial infrastructure, efficient FX market, availability of treasury talents, and sound regulatory and legal framework. Hong Kong has a comparative advantage in its role as a premier offshore renminbi centre and, having close ties with China, better established equity capital market as well as a more extensive network of international corporate and investment banks.

Under the three-tier banking system, Hong Kong has a highly developed banking market, with approximately 70% of the top 100 banks in the world having operations in Hong Kong. Being one of the most active markets for initial public offerings, Hong Kong's stock market was the fifth-largest in the world and the third-largest in Asia in terms of market capitalisation as at the end of April 2015. In addition, Hong Kong's debt market is one of the most liquid markets in Asia. By the end of April 2015, the outstanding amount of the Exchange Fund Bills and Notes was about HK$752.8bn, with a daily turnover averaged at HK$12.6bn.[3]

Tax treaties

In contrast, Singapore is often perceived as better in terms of geographic proximity to ASEAN countries, the availability and quality of treasury talent, a long-standing specific tax incentive for treasury centres (among other favourable tax incentives, including those in the financial services space) and a well-developed commodities market. Singapore also has a larger tax treaty network than Hong Kong in terms of the number of treaties. However, as a result of Hong Kong's active effort to expand its tax treaty network, Hong Kong now has a number of tax treaties offering a more favourable interest withholding tax rate than Singapore. Specifically on the CTC regimes in both locations, the new CTC incentive enacted by Hong Kong does leave little arbitrage between the two locations from a tax rate perspective.

Nevertheless, tax should never be the sole consideration in choosing the location of a CTC. The location should depend on the footprint and business needs of the corporate group and the physical location of the corporate treasury team actively managing the corporate group's treasury, and related treasury and financial risks. Going forward, as a direct result of changes happening globally to the international tax system through the Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting project, "aligning the location of the treasury team and the location where transactions are booked will be crucial for any MNC looking to access reduced rates of interest withholding tax under tax treaties, for example, and to manage its transfer pricing risk", says Eng Ping Yeo, EY ASEAN tax leader.

For corporate groups that focus solely on the ASEAN region, Singapore may offer a slight competitive advantage given its geographic proximity; for those corporate groups that have material business activities with or in mainland China and the rest of northeastern Asia, Hong Kong has a distinctive geographic advantage over Singapore. For mainland Chinese enterprises, Hong Kong is unquestionably the natural outbound gate.

The views reflected in this article are the views of the author and do not necessarily reflect the views of the global EY organisation or its member firms.

1 Asia Treasury Trailblazer Summit 2015, Hong Kong Monetary Authority, 30 April 2015 (www.hkma.gov.hk/eng/key-information/speech-speakers/pstpang/20150430-1.shtml)
2 Published by the Census and Statistics Department Hong Kong Special Administrative Region (www.statistics.gov.hk/pub/B11100042015AN15B0100.pdf)
3 *Hong Kong: The Facts* (www.gov.hk/en/about/abouthk/factsheets/docs/financial_services.pdf)

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