

Maritime Leasing Paper



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Executive Summary

1. Hong Kong is home to the world's fourth largest shipping registry and is the world's fifth busiest container port. Many leading shipowners, and operators have chosen Hong Kong as their base, thus attracting companies offering related services, such as maritime financing, insurance, legal support, shipbroking and ship management, which together make Hong Kong an international maritime centre. However, competition from other world cities for this maritime cluster is keen. This paper examines Hong Kong's strengths and weaknesses in this global competition and recommends strategies for Hong Kong to ensure the industry's sustainability and growth.
2. Among Hong Kong's strengths are its status as an international financial centre, its established common law system, its world-class port, its proximity to major sources of and markets for goods, its stable and competitive tax environment for shipping companies, and its young, well-educated workforce. The well-run shipping registry is also an asset, but its marginal value in deepening the Hong Kong maritime cluster has declined over time.
3. Hong Kong lags behind other major shipping centres in building a base for commercial principals, such as shipowners, lessors, carriers, investors, operators, and ship-management companies. If more of these principals are attracted to Hong Kong, related service providers will follow. Many tonnage providers around the world continue to search for an Asian base of operations. At the same time, many Mainland China vessel leasing companies with all or part of their fleet based or registered outside Mainland China in low tax jurisdictions are looking into housing their offshore ownership operations in respectable jurisdictions with a stable tax and legal environment, along with other considerations. All these activities present a real opportunity for Hong Kong.
4. One step to attract maritime players to set up and conduct business in Hong Kong is to make it easier for commercial principals to move key employees to Hong Kong, to facilitate the interaction between various different government departments and regulators, and to help the Marine Department to enhance its service and deal with its increased workload as a result of the enormous expansion of the ship register.
5. Another step is to raise Hong Kong's global profile. As one of the world's leading ports and flag states, Hong Kong should actively participate in and contribute to international industry bodies to enhance its position as a responsible centre of industry expertise and a leader in the development of the Belt and Road Initiative.
6. Stability, certainty and predictability are key factors in choosing a base for a shipping business. Hence, a transparent and consistent tax policy is crucial. In this respect, Hong Kong's legacy tax policy has clear advantages. However, some jurisdictions offer more

tax concessions and have more double tax agreements than Hong Kong does, so there is room for improvement.

7. Hong Kong needs to structure a program that combines its friendly legacy tax policy for global shipping, its core competency as a financial centre, and its deep balance sheet in order to attract more shipping activities to be based in Hong Kong. The reliance on tonnage size in the local ship register is not enough.
8. Hong Kong is a world-class financial centre and is well-placed to play a significant role in ship financing. Every year, the capital expenditure required for newbuilding vessels is approximately US\$80 – 100 billion. But traditional sources of capital from the shipping banks are shrinking, making their loans more expensive and harder to obtain, forcing many shipping companies to turn to alternative sources of finance. Export credit agencies (“ECAs”) in shipbuilding nations provide guarantees for facilities arranged by banks or direct lending. Perhaps some of these ECAs could be attracted to conduct their shipping business from Hong Kong or have ECA-related transactions arranged by banks based in Hong Kong.

Recommendations

9. To develop a significant maritime financing and leasing industry in Hong Kong, the Financial Services Development Council (“FSDC”) recommends the following:
 - a. **Capture more commercial principals, capital providers and lessors** who have meaningful activities in Hong Kong by ensuring the stability, consistency and transparency of Hong Kong’s section 23B tax regime.
 - b. **Offer credit and liquidity enhancement products by a sovereign-rated financial institution (“SRFI”).** An SRFI may support and endorse market-based and market tested credit and liquidity enhancement products and offer the products to qualified investors. The new fixed income financial products offered or enhanced by the SRFI would be on normal market terms and commercially viable. The objective of the new products is not to subsidize the shipping industry but to facilitate the development of ship financing.
 - c. **Ensure full consultation with the industry in implementation of OECD’s Base Erosion and Profit Shifting (“BEPS”) package.**¹ The OECD initiated a plan to counter BEPS in October 2015. Hong Kong joined the Inclusive Framework on BEPS in June 2016 to counter harmful tax practices. As part of the BEPS package, a mechanism is in place to review and monitor the preferential tax

¹ The BEPS Action Plan is a framework led by the OECD and G20 jurisdictions that targets tax planning strategies that exploit gaps and mismatches in tax rules among different jurisdictions so as to artificially shift profits to low or no-tax locations where there is little or no economic activity.

regimes relating to income from geographically mobile activities (including shipping activities) of all participating jurisdictions. As a participating jurisdiction, the Government, through the Inland Revenue Department, is reviewing its tax regime on shipping, and will take into account a number of factors, including whether the regime requires substantial activities. Given that section 23B has been the bedrock of the maritime activities in Hong Kong, the Government needs to conduct a full and deep consultation with the industry during its tax review.

- d. **Encourage the growth of shipping and maritime-related support and management services.** This can be done by including relevant business activities carried out in Hong Kong in a standalone tax regime under which the tax rates are competitive with other maritime centres. Specifically, concessions could be provided for “maritime and ship leasing management” and “maritime and shipping-related supporting services” activities by reducing their standard tax rate on profits by half or setting it not higher than 8.25%.
- e. **Nurture talent in the maritime cluster.** Leverage the Government’s initiatives, such as the Maritime and Aviation Training Fund (“MATF”), to reassess and/or develop policies to train and grow local talent and attract skilled labour from overseas to grow Hong Kong’s group of professionals with expertise in the maritime cluster. The MATF should consider initiatives covering educational or training schemes that are initiated by the private sector. Support for private sector training and educational initiatives are not uncommon in competing jurisdictions.
- f. **Conclude more double tax agreements (“DTAs”) with major shipping jurisdictions.** Hong Kong needs to put more effort into negotiating more DTAs. Hong Kong does not have DTAs with several jurisdictions that are important to Hong Kong shipping industry such as Australia and Brazil. As a consequence, cargo carried on Hong Kong-registered vessels may be subject to freight taxes which do not apply to vessels registered in some other jurisdictions. Hong Kong companies doing business in other jurisdictions with no DTA may be subject to a withholding tax on profits or interest remitted from the other jurisdictions.
- g. **Support international participation.** The Government should support Hong Kong-based organizations and companies in participating in and contributing to international industry bodies with a global footprint to enhance its position as a responsible centre of industry expertise and the leader in the development of the Belt and Road Initiative. Initiatives should include real and proactive support to attract foreign nonprofit industry bodies to domicile their regional offices in Hong Kong and to encourage Hong Kong-based industry bodies to participate in international industry meetings, conferences and activities.

- h. **Upgrade the Hong Kong Maritime and Port Board, or create a centralized Maritime Office.** This is for overseeing and coordinating maritime policies, regulations and initiatives, and regular quality reviews for the Hong Kong Ship Registry, as well as acting as a channel for private sector input for public policy formulation.

Introduction

1. Ships carry approximately 85% of world's trade cargo in 2016. Global seaborne trade is experiencing steady annual growth since 2010 - from 9,126 million tons in 2010 to an estimated figure of 11,599 million tons in 2017.² It is forecasted to grow further by 3.6% year-on-year in 2018.
2. Historically, Hong Kong has been an important maritime centre due to its geographical location. It houses the fourth largest shipping register and is the fifth busiest container port in the world. Leading shipowners, tonnage providers and ship operators have chosen to base their operations in Hong Kong. Naturally, their presence has attracted related services in maritime financing, insurance, legal services, ship broking and ship management to operate in Hong Kong. This group of shipowners, capital providers and professionals are often conveniently referred to as the "maritime cluster", which provides the critical mass in maintaining Hong Kong as a leading maritime and finance centre. However, Hong Kong encounters keen competition from other world cities for this maritime cluster. In relative terms, the maritime cluster of other competing cities is now larger than that of Hong Kong. Going forward, Hong Kong must maintain and enhance its competitive advantages of the maritime cluster for the sustainable growth of the industry.
3. In the 13th Five-Year Plan, the Chinese Central Government demonstrated its support to Hong Kong "in comprehensive and accurate implementation of the 'one country two systems'. Authorities in Mainland China support Hong Kong to consolidate and enhance its major positions in international finance, navigation and trading; to promote development of the service sector towards the high-end and high value-added direction. Hong Kong is also encouraged to facilitate Mainland China's bilateral opening and the development of the Belt and Road Initiative".³ It is clear that the maritime and shipping industry, supported by Hong Kong's leading position as a major international finance centre, has received the full-hearted support from the Central Government for development.
4. One of the major findings in a published research paper by the Hong Kong Trade Development Council ("HKTDC") states, "to enhance Hong Kong's competitiveness as a key ship finance centre, Hong Kong has to ensure that a virtuous cycle of building a diversified cluster of shipping companies and attracting 'commercial principals' in place, while leveraging its unique institutional strengths. Undoubtedly, commercial principals like shipowners, and ship management companies are the prime drivers for the value-chain activities of the shipping community. Once they are present, service providers,

² Clarksons Research, *Seaborne Trade Monitor*, Vol. 5 No.1 (January 2018, Clarksons Research Services Limited, London)

³ Hong Kong Financial Services Development Council, *The 13th Five-Year Plan: Opportunities for the Hong Kong Financial Industry and Policy Recommendations* (December 2016, FSDC, Hong Kong), 2.

including ship finance providers, will follow.”⁴ It is clear that the maritime cluster follows the principals, i.e. the critical decision-makers that are in control of the capital.

5. Is Hong Kong doing enough to attract these principals? According to Clarksons Research⁵, Hong Kong is the fourth largest shipping register or flag state in the world with a total gross tonnage (“GT”) of 113.2 million GT. By comparison, Singapore is ranked fifth with 85.4 million GT. Hong Kong is clearly an attractive place and jurisdiction for the principals to register their vessels.
6. Nevertheless, Clarksons Research also noted that in terms of owned fleets by nationality, i.e. tonnages owned by principals of different nationality, Hong Kong is ranked 12th with 27.3 million GT as of the year end of 2017. By comparison, Singapore is ranked 9th with 41.2 million GT.⁶ Rankings aside, while it is understandable that a large flag state would have many foreign owners operating offshore, a case can be made that: for Hong Kong, with 113.2 million GT in its register, there is only 27.3 million GT or 24% owned by Hong Kong principals. By comparison, for Singapore, with 85.4 million GT in its register, Singapore principals own 41.2 million GT or 48%. From these statistics, it is clear that Hong Kong has had a successful track record of building its register. At the same time, however, Hong Kong lags behind in building its base of commercial principals.
7. While the size and quality of the Hong Kong Shipping Register (“HKSR”) is an achievement for Hong Kong, it has reached a critical size where additional growth will need corresponding growth of resource in the Marine Department (“MARDEP”), and the marginal benefit of increasing the size of the HKSR is minimal. The more critical element for Hong Kong is to attract commercial principals to be based in Hong Kong, rather simply growing the HKSR.
8. In terms of financing, the statistics on newbuildings are of particular significance because these are vessels that have to be financed one way or another, from the principals’ own equity, public or private equity, proceeds raised from the equity capital markets (“ECM”), proceeds raised from the debt capital markets (“DCM”), mezzanine/junior debts from financial institutions to senior secured debts from financial institutions known generally as shipping banks. By Clarksons Research’s rough estimate, the total value of the world fleet is approximately US\$1.2 trillion, out of which approximately US\$250 billion represents newbuildings on order.⁷ With general industry practice of placing advanced orders 2 to 3 years before, new CAPEX to be financed each year is approximately US\$80-100 billion.

⁴ Winnie Tsui, ‘High Value-added Maritime Services: Ship Financing Opportunities’ (*HKTDC Research*, 13 February 2017) <http://economists-pick-research.hktdc.com/business-news/article/Research-Articles/High-Value-added-Maritime-Services-Ship-Financing-Opportunities/rp/en/1/1X000000/1X0A90X3.htm> accessed 21 May 2018.

⁵ Clarksons Research, *World Fleet Monitor*, Vol. 9 No. 1 (January 2018 Clarksons Research Services Limited, London)

⁶ *Ibid.*

⁷ See note 5 above.

9. As an international financial centre, Hong Kong is well placed to play a significant role in raising the financing that is required for the maritime industry. Traditional shipping banks will follow the principals and Hong Kong must be prepared to introduce measures to attract the principals. As suggested by the above statistics, there is room for improvement just to capture the principals that have vessels registered in Hong Kong but without a substantial local presence.
10. Principals look for a stable tax environment to conduct their businesses. The taxation of shipping revenue in Hong Kong is covered under section 23B of the Inland Revenue Ordinance (“IRO”). Hong Kong adopts a territorial basis of taxation. Accordingly, section 23B is based on a territorial concept, providing a tax exemption for international trading by Hong Kong flagged vessels, and a tax formula using Hong Kong versus global cargo uplift percentage for non-Hong Kong flagged vessels. Historically, section 23B has been the bedrock for the Hong Kong maritime cluster, providing certainty and clarity.
11. The aforementioned HKTDC Research paper⁸ correctly identifies the growing trend of a shrinking base of traditional shipping banks, which are being replaced by various alternative funding sources. In the past decade and a half, the landscape of capital providers for shipping has indeed changed. Today, in addition to traditional shipowners and lenders, there are many other capital providers including private equity funds, pure leasing companies, and operating lessors focused on structured products. These capital providers are active in the provision of significant capital from equity to debt for the maritime industry.
12. Many of these capital providers are the commercial principals who are active in owning and controlling the business of their vessels. They may be utilising the services of other capital providers, ship management companies, brokers and maritime legal and insurance services. They may have a need for finance and accounting professionals, chartering professionals, and operations professionals.
13. These capital providers originate from both overseas and Mainland China. Overseas investors in the US, Scandinavia, Germany, Italy, Greece, Japan, and Singapore in the form of shipowners, lessors and other forms of capital providers, notwithstanding the volatility of the past decade in the shipping market, continue to participate in shipping. In Mainland China, there has been tremendous growth in both traditional lending and leasing activities. Leasing companies related to large financial institutions have been the most active. Currently, most of the activities for these Mainland China leasing companies are based in Mainland China, while their vessels are typically registered offshore e.g. in Hong Kong, Panama, Liberia, Marshall Islands etc. Given the continued growth of this sector, and the implementation of the OECD’s BEPS Actions (see paragraph 15 below), there is a distinct opportunity for Hong Kong. Especially since some of these companies are considering housing their offshore ownership operations in respectable jurisdictions

⁸ See note 4 above.

where, among other considerations, they can enjoy a predictable and stable tax and legal environment.

14. Hong Kong is an internationally recognised financial hub and currently has 39 double tax treaties as well as 6 shipping income agreements with other jurisdictions. It should therefore consider how to attract both Mainland China-based lessors and international capital providers to set up their maritime leasing and shipping investment business in Hong Kong, thereby further expanding the growth of Hong Kong's maritime cluster.
15. Since the finalisation of the BEPS Actions⁹, lessors nominally based in tax havens have been under the close scrutiny of tax authorities globally. Hong Kong, as an international financial centre with an advanced infrastructure and deep maritime cluster, can be an attractive location for lessors to base their activities provided that it has the right Government policy to support the industry's growth.
16. There are opportunities for a Government-backed, sovereign rated financial institution to play a significant role in attracting these principals. This paper will further explore ways how these government-backed financial institutions can contribute to the industry and how they themselves can enjoy a reasonable return from their investments in line with market practice.
17. The Government has taken the initiative of introducing a concessionary tax regime for attracting more aircraft leasing companies to set up their aircraft leasing hubs in Hong Kong. The Inland Revenue (Amendment) (No.2) Bill 2017 was passed at the Legislative Council on 28 June 2017, establishing a concessionary tax regime to reduce the profits tax of qualifying aircraft lessors and aircraft leasing managers. The Government's initiative to introduce this concessionary tax regime is highly visionary and pragmatic, aiming to forge Hong Kong into an aircraft leasing and financing hubs within a short period. Accordingly, this concessionary tax regime will not only further diversify the financial services industry of Hong Kong, but also stimulate its economic growth, creating more employment opportunities and putting Hong Kong on the map of aircraft leasing and financing globally. Given the significance of the maritime and shipping industries to the Hong Kong economy, we strongly recommend the Government to introduce a more comprehensive tax regime for the maritime leasing and financing industry with a view to further expanding the maritime cluster by attracting international principals to set up their maritime leasing and financing hubs in Hong Kong. Please refer to the FSDC report in 2017 on Aircraft Leasing¹⁰ for details.

⁹ The BEPS Action Plan is a framework led by the OECD and G20 jurisdictions that targets tax planning strategies that exploit gaps and mismatches in tax rules among different jurisdictions so as to artificially shift profits to low or no-tax locations where there is little or no economic activity.

¹⁰ FSDC, *Recommendations for Developing Hong Kong as an Aircraft Leasing and Financing Hub* (July 2017, FSDC, Hong Kong)

Current issues challenging the shipping industry in Hong Kong, including the financing situation

18. The Hong Kong Maritime Industry Council commissioned the “Consultancy Study on Enhancing Hong Kong's Position as an International Maritime Centre”¹¹ in 2014 and identified the need to attract a Hong Kong-based maritime cluster. To do so, Hong Kong needs to be an attractive place to live and do business. Factors which contribute to creating a conducive environment include:

- Access to a pool of skilled labour
- Ease of doing business
- Proximity to business partners and markets
- Supportive government policies
- Clear and transparent tax and regulatory environment
- Comprehensive professional and other support services
- Free movement of money and efficient financial services
- Good transport and communication services
- Quality of life (e.g. housing, schools, medical facilities, air quality)¹²

19. This paper limits the scope and focuses the discussion on the following ongoing challenges faced by the shipping industry for making recommendations:

- a. Ship Register;
- b. Labour;
- c. Government;
- d. Tax; and
- e. Finance.

Ship Register

20. Notwithstanding the fact that the HKSR has been successful in its growth in size and is a part of Hong Kong's identity as a maritime centre, the fact is that the HKSR's marginal value in deepening the Hong Kong maritime cluster is negligible. The focus of the HKSR should not be on how it can help deepen the maritime cluster, but on the quality of the HKSR itself. As evident, the HKSR has been enormously successful since its inception in 1990, and this success brings pressure on the MARDEP to maintain service standards at the levels to which its users are accustomed. Funding for the HKSR stems from the Government's financial appropriations. Any profits generated by the HKSR are channelled back to the Government rather than being invested back into the HKSR to

¹¹ BMT Asia Pacific, *Consultancy Study on Enhancing Hong Kong's Position as an International Maritime Centre - Final Report* (April 2014) https://www.hkmpb.gov.hk/document/8870_IMC_Final_Report.pdf accessed on 21 May 2018.

¹² See note 11 above, 12.

further enhance its service delivery through recruitment of additional resources, training and incentivisation to professional staff. A paper entitled "*A Comparison between Hong Kong Shipping Register and Marshall Islands Registry*" prepared by Wah Kwong Shipping in 2016 is attached as **Appendix A** as reference to various areas of challenge faced by the MARDEP.

21. As one of the world's leading ports and flag jurisdictions, the Government should support Hong Kong-based organisations and companies to participate in and contribute to international industry bodies (usually NGOs or nonprofit organisations) with a global footprint.¹³ Support can come in various forms. The HKSAR, with its size, should generate adequate revenue to support such initiatives. Historically, Hong Kong-based organisations and companies have been very active members in these bodies. Through being a thought-leader in developing initiatives and regulations, for example to enhance health, safety and protection of the environment, Hong Kong will enhance its position as a responsible centre of industry expertise and the leader in the development of the Belt and Road Initiative.
22. Please also refer to the aforementioned Consultancy Study¹⁴ for a prior recommendation from industry on the setting up of a stand-alone maritime statutory body for Hong Kong.

Labour

23. While Hong Kong has a well-educated and young workforce, there is only a relatively small group of professionals with expertise in the maritime cluster. Mainland China and international employers have expressed that Hong Kong is comparatively much less friendly than Singapore when it comes to employing overseas staff. Hong Kong seems to operate on the principle that an employer must demonstrate that the relevant talent is not available in the local market before a foreigner can be employed. Compare this to other jurisdictions, where approaches range from an open policy on importation of foreign professionals, to the setting of target ratios of local to foreign employees, among others. This is easier for employers to manage as they develop their businesses over time.
24. Continued development of the Hong Kong maritime and aviation sectors hinges on the availability of quality labor. The Government set up a HK\$100 million Maritime and Aviation Training Fund ("MATF") on 1 April 2014 with a view to attracting new blood to expand the pool of talent, diversifying expertise of the workforce to meet the manpower demand of the maritime and aviation sectors as well as enhancing the overall competency and professionalism of the industries.
25. Having implemented for four years, more than 4,900 beneficiaries, including more than 3,000 persons from maritime sector and 1,900 from aviation sector, have been benefited from various MATF schemes and about HK\$45 million have been spent as at February

¹³ E.g. International Maritime Organisation, INTERTANKO, International Chamber of Shipping, World Shipping Council, INTERCARGO, and Asian Shipowners' Association.

¹⁴ See note 11 above.

2018. The Government plans to introduce more enhancement measures and injects new funds if necessary so as to continue to underpin the maritime development in Hong Kong. In particular, the Fund should include support to private sector training and educational initiatives. Given the nature of maritime activities, training and educational schemes are often highly specialized. As a result, there are times when private sector initiate specific training and education schemes either locally or abroad. Other competing jurisdictions support such private sector initiatives especially when a structure is put in place to ensure participants include local staff of such jurisdiction. MATF should consider this type of proactive and progressive approach.

Government

26. In order to attract principals, steps should be taken to facilitate the interaction with various different government departments and regulators required to set up and conduct businesses. Singapore adopts a "single window" approach, through which the Economic Development Board of Singapore ("EDBS") acts as central point of contact to coordinate dealings with various parts of the government (e.g. immigration, labour, tax, Maritime and Port Authority) to facilitate new entrants setting up business and also existing players in conducting their affairs. In contrast, the Hong Kong Maritime and Port Board ("HKMPB") play only an advisory role to the Government and do not involve representation from all relevant government departments. As a result, the HKMPB is much less effective than the EDBS in coordinating government efforts to develop the maritime cluster.

Tax

27. Taxation policy continues to be an important factor behind the choice of domicile for many shipowners, tonnage and capital providers, and other shipping related supporting services. The taxation of shipping revenue in Hong Kong is dealt with under section 23B of the IRO. The charter out of a Hong Kong registered ship which is engaged in international trade is exempt from profits tax on its charterhire income under section 23B. This has been the bedrock for the Hong Kong maritime cluster. Vessels which trade within Hong Kong waters or between Hong Kong waters and river trade waters are not exempt and carriage income on cargo uplifted in Hong Kong may be subject to profits tax in certain circumstances.

28. Section 23 utilises a "territorial source" principle of taxation and is generally regarded as competitive against comparable jurisdictions. However, in Singapore, principals can engage in case by case negotiations with the government to provide more tax certainty, especially for new businesses. While Hong Kong would refrain from bilateral negotiation and would pride itself to be fair and have one policy for all, it is important to have ways to reaffirm the principle under section 23B and to develop measures and policies in parallel with section 23B that can benefit or provide more tax certainties for principals based in Hong Kong.

29. Currently, section 23B applies to the income of shipowners but does not apply to the businesses that serve and support the vessels. Other competing maritime and shipping hubs, however, offer a wider range of tax incentives. For example, Singapore offers a wide range of incentives which operate to make Singapore a more cost competitive centre for business operations in Asia. In addition to a tax exemption on qualifying shipping income, concessionary tax rates are offered to shipping-related support services and on qualifying management income of leasing businesses. A copy of the PwC's publication, *"Singapore shipping industry- a glance at its tax regime"* in April 2017 is attached as **Appendix B**.
30. The Inland Revenue (Amendment) (No. 6) Bill 2017 (the "Bill"), gazetted on 29 December 2017, includes amendments to the IRO to ensure that certain tax regimes are consistent with the key actions arising from the OECD's BEPS Actions. One of the amendments concerns the determination of exempt sums for ship owners. Exempt sums mainly are ship-owning incomes derived from shipping operations with a Hong Kong registered ship from Hong Kong to high sea. These sums are exempted from the determination of the time of a shipowner carrying business in Hong Kong. In order to be an exempt sum, the Bill proposes to include a requirement that those activities that produce the exempt sum is required to be carried out in Hong Kong by the taxpayer, or arranged by the taxpayer to be carried out in Hong Kong. In addition, there will be threshold requirements for determining whether activities producing profits are carried out in Hong Kong. If the threshold requirements are not met, then the activities are not considered to be carried out in Hong Kong. Based on the Bill, the threshold requirements are measured by indicators such as (a) the number of full-time employees in Hong Kong engaged in the activities; and (b) the amount of expenditure incurred in Hong Kong for the activity. Whilst we support the importance of implementing the BEPS Actions to demonstrate the Government's commitment to combat cross-border tax evasion to preserve our competitiveness and reputation as an international financial and business centre, it is equally important that these threshold requirements should not impose unnecessary and unreasonable burdens for shipowners, adversely affecting Hong Kong's competitiveness. It is important for the Government to consult with the shipping industry to ensure these threshold requirements are commercially reasonable and to provide clear guidance and clarification prior to putting in place any prescribed thresholds.
31. Another area of concern is double tax treaties. Hong Kong needs to put more effort into negotiating more double tax agreements ("DTAs"). Currently Hong Kong has 39 DTAs as well as 6 shipping income agreements as compared with 84 for Singapore. According to the Hong Kong Shipowners Association, Hong Kong does not have DTAs with several jurisdictions that are important to Hong Kong shipping industry, including for example Argentina, Australia, Bangladesh, Brazil, the Philippines, Taiwan, Turkey and Ukraine, all of which are major sources of cargo carried on board by Hong Kong registered or managed vessels. As a consequence, cargo carried on Hong Kong-registered vessels may be subject to freight taxes which do not apply to vessels registered in some other jurisdictions. Hong Kong companies doing business in other jurisdictions with no DTA

may be subject to a withholding tax on profits or interest remitted from the other jurisdictions.

Finance

32. Hong Kong is an attractive centre for ship finance. 75 of the world's 100 largest banks have an operation in Hong Kong. There is no value-added tax or goods or services tax and no withholding tax on interest payments to overseas lenders or dividends to shareholders. There are no foreign exchange controls. The local currency is pegged to the US Dollar, which is the global currency of shipping. There is an active private equity market and a major stock market. Hong Kong has a well-deserved reputation as world-class financial centre. However, even for the top banks with shipping finance expertise, only a small portion of them would have dedicated shipping finance professional based in Hong Kong.
33. Traditional sources of capital from “Shipping Banks” are shrinking. In addition, feedback from the banks and shipowners suggest that there is often a maturity mismatch between the preferences of the banks versus the shipowners for the tenor of shipping loans. Insofar as the shipowners (the borrowers) are concerned, they will prefer the tenor of the shipping loans to be the longer the better, and in any case, should be longer than 10 years. However, banks will prefer shorter tenor within 10 years because of the additional risk assigned to longer term loans. Attaching higher risk weighting to longer term loans is a global trend and the standards are often stipulated in details in Basel Committee on Banking Supervision of the Bank for International Settlement.
34. Given such maturity mismatch, either the shipping loans have to go for shorter tenor than 10 years or the banks may be willing to provide longer than 10-year term loans but only at a significantly higher interest rate. Either is not conducive to developing Hong Kong into a maritime leasing and financing centre.
35. As a consequence of shipping bank loans becoming more expensive and harder to obtain, many shipping companies have turned to alternative sources of finance.
36. For vessels under construction, export credit agencies (“ECAs”) in shipbuilding nations have provided facilities. These are generally in the form of guarantees for facilities arranged by commercial/shipping banks or direct lending most often through co-financing with commercial/shipping banks. With Mainland China, South Korea and Japan being the 3 largest shipbuilding nations, the main ECAs active in ship finance are KEXIM and K-Sure in South Korea, JBIC and NEXI in Japan and China-EXIM and Sinosure in PRC. Some European ECAs (e.g. Atradius, SACE, Coface, Hermes) also support projects for vessels or equipment built in Europe. This ECA-financing or credit support is competitively priced and is a very valuable source of funding in the current market, but is only available to acceptable corporate credits and for newbuilding finance. It is not available to start-up or smaller companies, or for second-hand purchases or refinancings.

This being said, efforts must be made either to attract some of these ECAs to conduct their shipping business in Hong Kong or to ensure ECA-related transactions are arranged by banks based in Hong Kong.

37. It is also worthwhile to note that in addition to the ECAs which have to follow OECD guidelines (if they belong to an OECD country), policy banks from major maritime countries such as China Development Bank in Mainland China, Development Bank of Japan Inc. in Japan, Korea Development Bank in Korea, KfW Development Bank in Germany etc, have been active in supporting the shipping industry with pure commercial, market driven financing products. These policy banks' involvements usually come with the requirement of certain "local" elements that would serve their respective national interests. Again, while these financing products are not for everyone, efforts must be made to ensure that some of these financings are arranged through Hong Kong. It can also be a hint that Hong Kong could possibly utilize part of its huge reserve to support the shipping industry in a market driven and commercially proven way.
38. Following CBRC's promulgation of rules governing financial leasing companies in 2007 and subsequent reforms of the Mainland Chinese leasing industry, several Mainland Chinese leasing companies have become active internationally, offering ship leasing as an alternative to conventional bank finance. Similar to many other tonnage and capital providers, these leasing companies set up ship-owing entities in tax neutral jurisdictions to house non-Mainland Chinese flag vessels. Most of these leasing companies operate out of Beijing, Shanghai or Shenzhen and do not have operating units outside of Mainland China. With the oncoming BEPS initiative, Hong Kong offers a robust financial, legal and tax environment for them to establish operating unit outside of Mainland China.
39. Hong Kong has well established ECM and DCM. However, as shipping companies are mostly private companies with moderate financials, only a few substantial listed or state-owned shipping companies can enjoy access to such capital. A good rating is also difficult to come by for shipping companies as the industry itself is quite leveraged and volatile. Therefore, even DCM opportunities would usually demand credit enhancement from a structuring point of view.
40. Alternative finance for shipping has also come from private equity, hedge funds and pension funds and high net worth individuals. It is difficult to identify the full extent of such activity as many deals are private and details are not disclosed in the public domain. But such funding is usually with low gearing and much higher cost than is achieved by companies which can still obtain bank funding. There is an active alternative finance industry in Hong Kong, but the synergies with ship finance opportunities should be encouraged.
41. With limited bank debt financing available in the current market, owners have to look for alternative sources of capital to finance shipping investments or to provide extra credit

support to obtain bank funding. Hong Kong has to compete with other global financial centres. With profits from shipping income generally exempt from tax, one obvious opportunity is to introduce measures to encourage alternative financing products being generated from Hong Kong to enhance Hong Kong's competitiveness as a ship finance centre.

Recommendations on how to develop the maritime financing & leasing industry in Hong Kong

42. Given the significance of the Belt and Road and the Greater Bay Area initiatives, the development of the maritime industry should be one of the core focuses for the Government. These initiatives offer a historic opportunity for Hong Kong to demonstrate its unique position in Mainland China, its prominent role as a business hub in Asia, its sophisticated financial markets and well developed legal system. In order for Hong Kong to further develop and excel as a leading international finance and shipping centre, the current issues and challenges set out in the preceding pages should be addressed. In addition, in order to further enhance Hong Kong as a place for shipping business, the FSDC recommends the following proposals to develop a more business-friendly platform to attract maritime lessors and other principals to Hong Kong and encourage growth.

- a. Capture those commercial principals, capital providers and lessors who are willing to base meaningful activities in Hong Kong by:
 - i. Ensuring the stability, consistency, and transparency of Hong Kong's section 23B tax regime, and promoting Hong Kong's section 23B tax regime in a proactive manner; and
 - ii. Allowing qualified investors to access market-based, market-ready credit and liquidity enhancement products supported and/or endorsed by a sovereign-rated financial institution.
- b. Ensure full consultation with the industry as the Government reviews and implements OECD's BEPS package while recognizing that section 23B tax regime on shipping activities in Hong Kong has been and continues to be the bedrock of the maritime activities based in Hong Kong.
- c. Encourage the growth of shipping and maritime-related support and management services in Hong Kong by including these services in a standalone tax regime. Specifically, consider providing concession for "maritime" and ship leasing management" and "maritime and shipping-related supporting services" activities by reducing their standard profits tax rate by half or setting it not higher than 8.25%.
- d. Nurture talent in the maritime cluster by leveraging on Government's initiatives (e.g. the Maritime and Aviation Training Fund) to train and grow local talent and attract skilled labour from overseas to grow Hong Kong's group of professionals with expertise in the maritime cluster. MATF should consider initiatives covering educational or training schemes that are initiated by the private sector. Support for private sector training and educational initiatives are not uncommon in competing jurisdictions.

- e. Conclude more DTAs with major shipping jurisdictions, in particular Australia and Brazil.
 - f. Support Hong Kong-based organisations and companies to participate in and contribute to international industry bodies with a global footprint for Hong Kong to enhance its position as a responsible centre of industry expertise and the leader in the development of the Belt and Road Initiative. Initiatives should include real and proactive support to attract foreign nonprofit industry bodies to domicile their regional offices in Hong Kong and to encourage Hong Kong-based industry bodies to participate in international industry meetings, conferences and activities.
 - g. Upgrade the HKMPB or create a centralised Maritime Office overseeing maritime and shipping-related policy, regulation, other initiatives and act as a channel for private sector input into the policy process.
43. Any tax incentives proposed to the maritime industry must contain the clarity and certainty required and should consult with the industry in order to achieve the desired effect. While the shipping industry and tax policies may be under the purview of different government departments, it would be most effective for cross-departmental coordination in formulating tax incentives that are practical and acceptable to the shipping industry. Furthermore, we would recommend benchmarking the tax incentives that are offered by the Singapore Government for the shipping industry so that the tax incentives are competitive and attractive to the industry as a whole.

Maritime and ship leasing management and maritime and shipping-related support services regime

44. In order to promote maritime and ship leasing as well as other maritime and shipping-related businesses in Hong Kong, we would urge the Government to provide a tax concession including a reduction of the standard profits tax rate for “maritime and ship leasing management” and “maritime and shipping-related supporting services” activities, similar to the approach adopted by Singapore. For example, similar to the proposed amendments under the Bill, such businesses will only benefit from the tax concession if substantial activities are undertaken in Hong Kong. The proposed tax concession can draw reference to the aircraft leasing regime launched in 2017 and its implementation to date.
45. We would ask the Government to discuss further with the stakeholders of the maritime and shipping industry in order to ensure the proposed activities of these qualifying businesses are appropriate and will be able to support the growth of the maritime cluster in Hong Kong.

46. We further recommend that these qualifying businesses should receive a concessionary tax rate of not higher than 8.25% or the half rate of the standard profits tax rate as the current rate levied by the Inland Revenue of Singapore is 10% on such type of services.

Qualified tonnage and capital providers

47. Attracting tonnage providers, with particular focus on lessors and capital providers to base their activities in Hong Kong should be the primary objective. Success in attracting these activities would not only deepen Hong Kong's maritime cluster, but also create demand for supporting services. To this end, not only should these tonnage providers enjoy section 23B, which is as of right, but they should also be able to elect to fulfil certain requirements that classify them as "qualifying tonnage and capital providers". Qualifying tonnage and capital providers should then also have the option to enjoy access to additional financial products that can be beneficial to their business (See below paragraph 48). These financial products are market-based, market proven credit and yield enhancement products. Other government-backed entities offer similar products in their respective jurisdictions both in support of their local businesses and on a straight commercial basis.
48. The qualifying tonnage and capital providers must have the necessary "substance" in Hong Kong in order to benefit from such incentives. This should become one of the considerations for overseas maritime lessors to decide whether they should set up a leasing platform in Hong Kong to carry out maritime leasing business.

How a sovereign rated financial institution can help maritime leasing and financing business

49. In view of the shrinking lending capacities from traditional lenders and the maturity mismatch between lenders' and borrowers' expectations in private shipping loans, an existing or newly setup entity with strong credit standing, e.g. a Hong Kong sovereign rated financial institution ("SRFI") can perform a facilitating role by various means as follows:
- a. Shipping loan insurance: the SRFI can explore providing insurance for the whole or part of a shipping loan, the insurance premium will have to be borne by the borrower, similar to loan insurance or guarantee for corporate lending.
 - b. Co-financing of securitized shipping loans: shipping loans can be securitized into bonds backed by shipping loans, the SRFI can explore taking up a certain tranche of the bond, say the longer-dated tranche, so that the lower risk rated tranches can trade better in the capital market, or the SRFI can buy up a certain proportion of the bonds backed by shipping loans at issue in the primary market.
 - c. Loan purchase: SRFI may consider buying shipping loans directly from the banks, so the banks can then allocate the relevant capital for use in new loan facilities.

50. All the above three ways are credit and liquidity enhancement products that on one hand supports qualifying tonnage and capital providers in their financial planning, and at the same time, help the banking sector to address the lending capacity issues including maturity mismatch and will give rise to new fixed income financial products in Hong Kong, thus helping the development of the Hong Kong debt market. The new fixed income financial products offered or enhanced by the SRFI would be on normal market terms and commercially viable. The objective of the new products is not to subsidize the shipping industry but to facilitate the development of ship financing. Such market based and market tested products are also being offered in other jurisdictions.

Other comments / considerations

51. When preparing the recommendations / proposals contained in this paper, the FSDC is cognisant of the fact that Hong Kong does not wish to be seen internationally (including by the OECD) as a tax harmful jurisdiction. These recommendations / proposals would help in promoting Hong Kong as a maritime and ship leasing and financing centre, and providing such tax certainty and transparency in the Hong Kong tax law, which would benefit Hong Kong in the international arena.

52. Given the unsatisfied demand of professionals with expertise in the maritime cluster, training and developing local talents is an urgent priority for the Government and the industry. The industry is encouraged to coordinate with the Government to utilize the MATF and develop relevant MATF schemes to nurture local talents.

53. Hong Kong needs to put more effort into negotiating more DTAs. Hong Kong does not have DTAs with several jurisdictions that are important to Hong Kong shipping industry such as Australia and Brazil. Jurisdictions that are major sources of cargo carried on board by Hong Kong registered or managed vessels should be prioritized for DTA negotiation, including for example Argentina, Australia, Bangladesh, Brazil, the Philippines, Taiwan, Turkey and Ukraine.

54. In order to drive the development of the maritime industry in Hong Kong, it will be necessary for the Government to upgrade the HKMPB or create a centralised Maritime Office. The Maritime Office should be charged with overseeing maritime-related policy, regulation and other initiatives, regular quality review for the HKSR, and ensuring that the goals of maritime strategies are met. The Maritime Office would be empowered to coordinate relevant public sector initiatives and policies, and act as a channel for private sector input into the policy process.

Appendix A

A Comparison between Hong Kong Shipping Register and Marshall Islands Registry - 2016 by Wah Kwong Shipping

Traditionally the Hong Kong flag has been gaining massive supports from local shipowners and broadly endorsed by the Hong Kong based shipping communities. Past few years have seen a rapid growth in the Hong Kong flagged fleet. As of Nov 2014, with a tonnage over 91 million gross ton, Hong Kong registered fleet is currently the fourth largest in the world and proudly the largest national fleet (as opposed to Flag of Convenience).

However, with fleet size growing, the service quality of the Hong Kong Shipping Register seems to be falling behind in recent years, not as competitive as other world class registry. In comparison with the third largest global registry – the Marshall Islands Registry whose service is highly recognised by many owners, the Hong Kong Shipping Register are lagging in many aspects. We would like to outline below major differences between two registries, hope to bring about some rethinking by concerned parties.

1. Entity

One of the most obvious factors differentiating the Marshall Islands Registry from the Hong Kong Shipping Register is that the former is founded as a profit generating company whilst the latter is an organ of a government body.

The Hong Kong Shipping Register (the HKSR) is operated by the Government of the Hong Kong Special Administrative Region through the Marine Department (the MARDEP). In essence the staffs handling shipping registry matters on a daily basis are civil servants and the funding of the HKSR stems from government financial appropriations. As a consequence, expenditures in the MARDEP are regulated by government guidelines and initiatives are probably much restricted. Individuals as civil servants, they are usually inflexible and less motivated to improve their service compared to employees of the corporate bodies. Moreover, sadly after the ‘2012 Lamma Island Incident’, the local maritime community has found that a blame culture for making mistakes tend to be rooted in the MARDEP encouraging a less proactive working environment.

On the other hand, the Marshall Islands Registry is administrated under a private company framework-- a company called International Registries, Inc (IRI), headquartered in Virginia, USA. The Trust Company of the Marshall Islands (the TCMI) and its parent company IRI through a joint venture agreement with the Marshall Islands government is authorised by legislation to administer the maritime and corporate programmes for the Marshall Islands. It is understood that the US government has a prime interest in the Marshall Islands Registry, but directed by its board, IRI is a self-governed entity which has flexibility and high incentives to invest on their services. Currently IRI has an army of over 250 own staffs

worldwide, and they are all fulltime employees which are highly committed to serve their clients – shipowners.

2. Presence

Affiliated with MARDEP, HKSR has only one office in the world. The official working hours are Monday to Friday, 0900-1800 local time. Outside the official working hours, or facing adverse weather conditions i.e. Number 8 signal storm or above, the MARDEP staff will be difficult to reach with no email or telephone calls expected to be replied to or answered.

The Marshall Islands Registry has a rather different approach which is under the concept of “decentralisation”. Other than one head office controlling and administering everything, they have 27 offices all over the world in various time zones. Each IRI office can provide almost full range of services which can be offered by their headquarters, such as registering a vessel or recording a mortgage. Endowed with more discretion, each regional office can respond shipowners’ requests directly which shortens response time significantly.

With abundant funds and increasing ambitions to develop their business, the Marshall Islands Registry is actively expanding their footprints all over the world. They sponsor various shipping forums and functions in the major maritime hubs and financial centres to attract global attention. After the 2008 shipping crisis, for instance, the Marshall Islands Registry has speed up its pace of growth and have become even more passionate, remarkably almost half of its 27 regional offices have been set up since the year of 2008 and it seems that its efforts have paid off.



Marshall Islands Registry Branch Offices

3. Ship Registry

Changing vessel ownership process or discharging of vessel mortgages at the HKSR is constrained by office working hours. Processing time is generally much longer than other top flag registries, which is possibly due to manpower shortage.

One particular difficulty shipowners may encounter is when a closing being carried out overseas. Owner's preference is to have full set of original certificates on board immediately after closing and registration is completed. The Hong Kong Shipping Register does not have a local office for certificate issuance, and they rarely fly people from Hong Kong for closing. Therefore, for shipowners, they have to have their own staff standby and take the first flight out of Hong Kong once they got the certificates from MARDEP.

In contrast, the Marshall Islands Registry is able to send their staff from their local network to the spot wherever the vessel transaction takes place to issue certificates. If it cannot send its own staff, it gives POA and delegates that power to their contacted local surveyor. All of these are part of the Marshall Islands Registry's global service and free of charge to owners.

4. Technical Supports

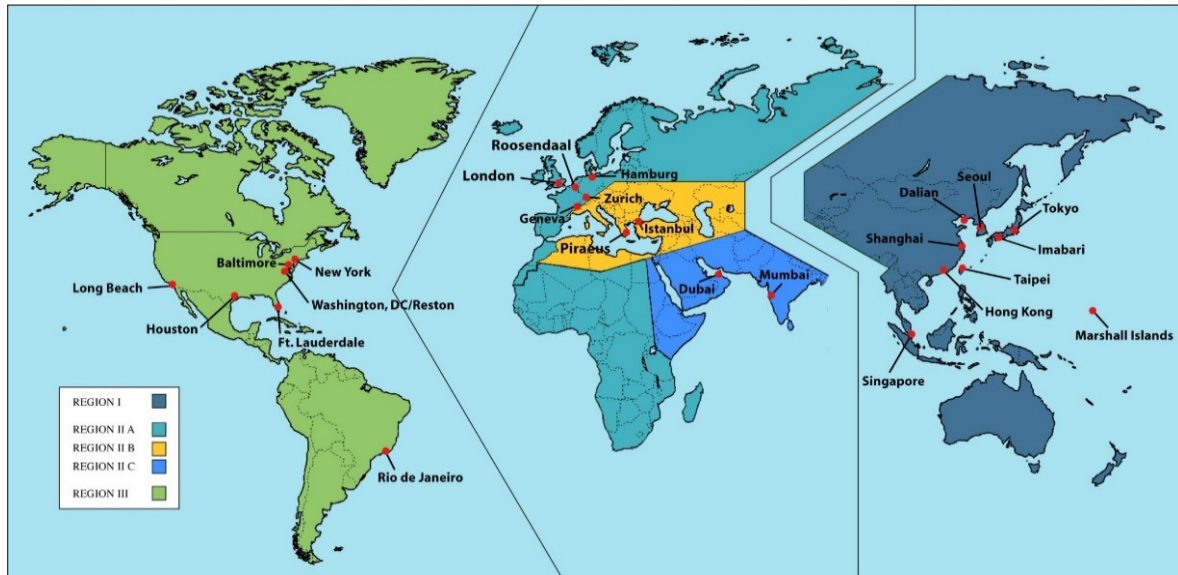
The MARDEP has different email addresses for each department and with working timing from 0900-1800 hours on Monday to Friday, and there is very constrained technical support available outside of the designated timing. The supports on many technical issues are often directed to the Recognised Organisations (the RO) and hence shipowners will usually depend on Class technical advisories, which are often taken days to get.

The Marshall Islands Registry has a unique email address to receive all operational or technical enquiries from owners. The worldwide regional offices have been divided into three different time zones covering 24 hours / 7 days operation. The system allocates the inquiry to a particular regional office and instruct the regional technical expert to handle the problem however when that particular office is closed, other offices take over and respond to the owners. Thus shipowners gain reply from the technical expert within their operating hours. It is asserted that each enquiry will be replied normally within four hours.

The IRI Technical Department is constituted of individuals of various nationalities with several years of experience in the maritime industry and have backgrounds of Classification Societies, P&I / H&M surveyors, shipowners, ship management, shipyards, PSC like United States Coast Guard, and specialists in a particular field or vessel type. The dispensation, exemptions etc. are few services which can be issued by any of the IRI branch offices without intervention or waiting for approval by head-office or the most senior officer. Whereas if a Hong Kong flag vessel needs a dispensation/exemption to sail in some extraordinary/emergency cases, under the current MARDEP structure email confirmation may be sent out by Duty Officer within/outside of work hours but the official documents would only

be dispatched subject to MARDEP Director's signature which means a possible delay of time, sometimes only email instructions are received and dispensation is never received.

Another benefit from decentralisation is that each regional office has a better understanding of the local language and cultural. They can deal with local issues such as PSC inspections more efficiently.



Marshall Islands Registry Regional Offices

5. IMO Participations

The International Maritime Organization (the IMO) committee meetings provide member states a great platform to reflect owners' interests regarding the various topics under the flag states.

Hong Kong is an important maritime hub and the fourth largest shipping registry thus an active participation in the IMO's Marine Environment Protection Committee (the MEPC) and Marine Safety Committee (the MSC) meetings is highly expected. The members of Hong Kong Shipping Consultative Committee (the SCC) often are invited to give comments on issues which would be discussed in the forthcoming IMO meetings but little feedback has been given afterwards. Most of the times the minutes of the SCC meetings are given after many months or sometime prior to start of next SCC meeting. The actual participation level of the Hong Kong representatives in the meeting and how the issues are discussed are unknown.

On the contrary, the Marshall Islands Registry claims to have the largest delegation group in the IMO MEPC and MSC meetings, even shipowners are sometimes invited to attend these meeting to raise voices, which amplifies shipowners' interests. The Marshall Islands Quality Council (the MIQC) leads the advisory group and the MIQC meetings are chaired by the representatives of the owners flying Marshall Islands flags.

6. Flag State Inspections

Regarding vessel quality control, the HKSR has no flag state vessel inspection requirement on an annual basis, and the staff will only attend the vessel once the vessel is detained under the PSC inspection. However the Marshall Islands Registry has implemented annual flag state inspections (the FSI) to check vessels' conditions and ensure ships to rectify faults prior to being caught by PSC. An FSI is claimed to be carried out for 6-8 hours of full inspection hence a better quality control is expected. It asserts that the FSI has higher inspection standards than PSC inspections to eliminate potential risks for detentions.

As a result, the Marshall Islands Registry fleets have an impressive overall performance. The flag state of Marshall Islands has been included on the USCG's Qualship 21 roster for ten consecutive years outperforming Hong Kong Shipping Register and it continues to be included on the White Lists of both Paris and Tokyo MoUs.

7. Guidance

Regulation updates and technical circulars are very important to shipowners regarding daily operations. The guidance from Hong Kong flag is often based on IMO circulars and extra information is missing. The response and delivery of various support including security information to shipping is very prompt in form of Marine Notices by IRI.

8. Conclusion

Ship Registers are now a competitive global business. The Marshall Islands Registry, through its administration by International Registries Inc operates as a commercial entity but through proper administration and regulation, offers shipowners a first class service. The Hong Kong Register should consider out-sourcing the Register to a commercial company under a contract from the government in order to ensure that a full service as offered by commercial registries can be provided without the restrictions which come from being a direct government body and hence giving it the ability to hire dedicated industry professionals. This would also allow the Marine Department to focus on the primary area of maritime safety and administration in the Port of Hong Kong. An alternative idea will be to 'out-source' the Register to the new maritime statutory body that is being consulted on by the Maritime Industry Council under the Transportation and House Bureau. This will not only allow the hiring of industry professionals, it will also provide services to the maritime industry (just like HK Productivity Council provides services to the manufacturing industry), but most importantly, it will provide a major source of revenue for the statutory body.

Appendix B

Singapore shipping industry – a glance at its tax regime (April 2017) by PwC

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1 Executive Summary

Tax Regime	Tax incentive
Automatic Tax Exemption for Singapore-Registered Ships (MSI – SRS)	<ul style="list-style-type: none"> • Tax exemption on: <ul style="list-style-type: none"> ❖ Qualifying shipping income (as stipulated in Section 13A of the Singapore Income Tax Act); ❖ Withholding tax on certain payments made in respect of qualifying loans with foreign lenders to finance the purchase or construction of qualifying assets
Approved International Shipping Enterprise award for Foreign-Registered Ships (MSI – AIS)	<ul style="list-style-type: none"> • Tax exemption on <ul style="list-style-type: none"> ❖ Qualifying shipping income (as stipulated in Section 13F of the Singapore Income Tax Act); ❖ Dividend income received from overseas subsidiaries paid out of their shipping profits; ❖ Qualifying profits remitted from approved foreign branches ❖ Withholding tax on certain payments made in respect of qualifying loans with foreign lenders to finance the purchase or construction of qualifying assets
Maritime Leasing (Ship) award (MSI-ML (Ship))	<ul style="list-style-type: none"> • Tax exemption on their qualifying income; and • Concessionary tax rate of 10% on the qualifying management income
Maritime Leasing (Container) award (MSI-ML (Container))	<ul style="list-style-type: none"> • Concessionary tax rate of 5% or 10% on their qualifying income; and • Concessionary tax rate of 10% on the qualifying management income
Supporting Shipping Services award (MSI – SSS)	<ul style="list-style-type: none"> • Concessionary tax rate of 10% on incremental income derived from the provision of approved shipping-related support services

2 Existing Singapore's tax regime for Shipping Business

Tax General in Singapore

- In the absence of specific tax incentives, the standard rate of corporate income tax is currently 17%
- 75% of the first SGD10,000 of chargeable income and 50% of the next SGD290,000 are exempt from tax
- The balance of chargeable income in excess of SGD300,000 is fully taxable at the standard rate of 17%

3 Automatic tax exemption for Singapore-Registered Ships (MSI – SRS)

- The MSI-SRS tax exemption is governed under Section 13A of the Singapore Income Tax Act (SITA). Generally speaking, it provides for automatic tax exemption on qualifying shipping income derived from the operation of Singapore-flagged vessels outside the port of Singapore. The tax exemption is available to a shipping enterprise who is an owner or operator of a Singapore flagged vessel.
- The qualifying income which is exempt from tax under Section 13A includes the following:
 - (a) freight income;
 - (b) income from the towing or salvage operations;
 - (c) bareboat or time charter income;
 - (d) income from operating a dredger, seismic vessel (including an oil rig) or vessel used for offshore oil and gas activity;
 - (e) foreign exchange and risk management activities which are carried out in connection with and incidental to its operation
 - (f) the provision of ship management services to any qualifying company in respect of Singapore ships owned or operated by the qualifying company; and
 - (g) Mobilisation fees, demobilisation fees, holding fees and incidental container rental income that are derived in the course of above described shipping operations.
- The Section 13A tax exemption is also extended to qualifying income from operation of foreign vessels. However, this exemption only applies to freight income derived by foreign vessel from carriage (other than within the limits of the port of Singapore) of passengers, mails, livestock or goods shipped in Singapore (except for trans-

shipment). Effectively, this means that Singapore does not levy freight tax on a non-resident ship-owner whose ships call at Singapore port to uplift goods.

- If the Singapore-flagged ship operates solely in Singapore waters, the income would be fully taxable.
- Tax exemption has been granted to qualifying ship operators and ship lessors on the gains from the disposal of vessels. This exemption does not apply to ship traders or ship builders.

Eligible parties for the automatic exemption:

- Only companies (resident and non-resident) owning or operating ships are eligible for the exemptions

Remarks:

- Exemptions are granted **automatically** (given certain criteria are met)
- In addition, automatic withholding tax exemption will be granted on certain payments made in respect of qualifying loans entered into on or before 31 May 2021 with foreign lenders to finance the purchase or construction of qualifying assets e.g. Singapore ships, subject to conditions. The applicant needs to submit a self-declaration form within specified timeframe for the automatic withholding tax exemption to apply.

4 Maritime Sector Incentives

4.1 Approved International Shipping Enterprise (MSI - AIS) award

- Shipping companies that own or operate a fleet of foreign-registered ships can apply.
- Successful applicants would either be granted the MSI-AIS status or the MSI-AIS (Entry Player) status, depending on their scale of operations.
- The MSI-AIS incentive is administered by the Maritime Port Authority of Singapore (MPA) and is granted on a case-by-case basis upon application. The incentive operates for an initial period of 10 years (subject to a 5th year review), after which an application can be made for the tax exemption to be extended beyond the initial 10 years up to a maximum of 40 years.

Eligible parties for MSI-AIS award:

- Applicant with a good track record, demonstrable business plan and a commitment to expand its shipping operations in Singapore may apply for the MSI-AIS award.

- Applicant must be able to demonstrate in its business plan how the shipping operations will generate economic contributions in Singapore, which include local business spending, how it can contribute to grow local manpower expertise, the strategic or commercial decision making functions that will be undertaken in Singapore, how it will expand its shipping operations from Singapore.
- The MSI-AIS incentive is a tax incentive applicable to Singapore companies owning or operating foreign-flagged vessels. Under this incentive, qualifying income from international shipping is tax exempt under Section 13F of the SITA. The qualifying income which is exempt from tax includes:
 - (a) freight income;
 - (b) time and bareboat charter income;
 - (c) income / including charter income from towing and salvage operations carried out from outside the port of Singapore;
 - (d) income / including charter income from any dredger, seismic ship or any vessel used for offshore oil or gas activity;
 - (e) foreign exchange gains, and gains from risk management activities derived by shipping companies in respect of foreign-flagged ships owned by MSI-AIS companies;
 - (f) the provision of ship management services to any qualifying special purpose vehicle in respect of any ships owned or operated by the qualifying special purpose vehicle; and
 - (g) Mobilisation fees, demobilisation fees, holding fees and incidental container rental income that are derived in the course of above described shipping operations.
- Exemption has been granted to qualifying ship operators and ship lessors on the gains from the disposal of vessels. This exemption does not apply to ship traders or ship builders.
- Dividend income received from overseas subsidiaries paid out of their shipping profits would also be tax exempt in Singapore if these overseas subsidiaries have the Approved Network Company (“ANC”) status. The ANC application for overseas subsidiaries is usually submitted at the time of application for the MSI-AIS status of the Singapore resident company.
- Tax exemption can also be granted to qualifying profits remitted from approved foreign branches by MSI-AIS companies.

4.2 Maritime Leasing (MSI-ML) award

- MSI-ML (Ship) award (to be discussed further in Section 4.2.1)
- MSI-ML (Container) award (to be discussed further in Section 4.2.2)
- Successful applicants will be granted the status for a period of 5 years
- Designed to encourage entities to use Singapore as their capital and funding base to finance their vessels and sea containers
- Qualifying entities include companies, funds, business trusts and partnerships incorporated or registered in Singapore
- Approved investment managers of approved shipping or container investment enterprises under the schemes may also receive a 10% concessionary tax rate on their qualifying management income.

Eligible parties for MSI-ML award:

- Applicant with a good track record, demonstrable business plan and a commitment to expand its shipping and container financing operations in Singapore may apply for the MSI-ML award on or before 31 May 2021.
- Applicant must be able to demonstrate in its business plan how the shipping or container financing operations will generate economic contributions in Singapore, which include local business spending, number of professionals employed, the strategic or commercial decision making functions that will be undertaken in Singapore, how it can contribute to the ship or container financing cluster in Singapore.

4.2.1 Maritime Leasing (Ship) award (MSI - ML (Ship))

Tax exemption under MSI-ML (Ship) award

Under the MSI-ML (Ship) award, approved shipping investment enterprises may enjoy tax exemption on their qualifying income, which includes:

- Income derived from the chartering or finance leasing of seagoing ships to specified persons for use outside the port limits of Singapore.
- Income derived from foreign exchange and risk management activities that are carried out in connection with and incidental to the qualifying ship leasing activities.
- Gains derived from the sale of seagoing ships, seagoing ships under construction (including new building contracts) and sale of all of the

issued ordinary shares in a qualifying special-purpose company that is the owner of any seagoing ship or is the buyer under a contract for the construction of any seagoing ship.

- Dividend income or share of profits from approved foreign ship-owning entities that are distributed out of qualifying ship leasing activities.

4.2.2 Maritime Leasing (Container) award (MSI - ML (Container))

Tax incentives under MSI-ML (Container) award

Under the MSI-ML (Container) award, approved container investment enterprises may receive a concessionary tax rate of 5% or 10% on their qualifying income, which includes:

- Income derived from the operating or finance leasing of sea containers that are used for the international transportation of goods
- Income derived from the leasing of intermodal equipment that is incidental to the leasing of qualifying containers
- Income derived from foreign exchange and risk management activities that are carried out in connection with and incidental to the qualifying container leasing activities
- Dividend income or share of profits from approved foreign container asset-owning entities that are distributed out of qualifying container leasing activities

4.3 Supporting Shipping Services (MSI-SSS) award

- The MSI-SSS scheme is administered by the MPA and is granted on a case-by-case basis upon application. The MSI-SSS scheme operates for a maximum period of 5 years. From 24 February 2015, an application can be made for the concessionary tax rate to be extended for another 5 years subject to qualifying conditions and higher economic commitments.
- Aims to promote the growth of ancillary shipping service providers and to encourage shipping conglomerates to set up their corporate services functions in Singapore
- An approved MSI-SSS company will enjoy a 10% concessionary tax rate on incremental income derived from the provision of approved shipping-related support services such as ship broking, forward freight agreement trading, ship management, ship agency, freight forwarding, logistics services and qualifying corporate services

Eligible parties for MSI-SSS award:

- Applicant with a good track record, demonstrable business plan and a commitment to expand its ancillary shipping activities in Singapore may apply for the MSI-SSS award on or before 31 May 2021
- Applicant must be able to demonstrate in its business plan how the provision of the ancillary shipping activities will generate economic contributions in Singapore, which include local business spending, number of professionals employed, how it can contribute to the ancillary services sector

5 Other taxes

Freight uplift income from Singapore

- Shipowners and charterers are exempt from tax on their uplift of freight from Singapore. This exemption applies to non-resident shipowners and charterers, resident shipping companies, and companies granted the MSI-AIS award.
- It does not, however, cover income from the carriage solely within the limits of the Port of Singapore.

Withholding tax

- (1) Automatic WHT exemption on interest and related payments made in respect of loans obtained to finance the purchase or construction of ships

Who is eligible?

- The exemption is available to:
 - MSI-Shipping Enterprise (Singapore Registry of Ships) (MSI-SRS);
 - MSI-Approved International Shipping Enterprise (MSI-AIS) companies; and
 - MSI-Maritime Leasing (Ship) [MSI-ML (Ship)] entities.

- (2) Automatic WHT exemption on interest and related payments made in respect of loans obtained to finance the purchase of containers and intermodal equipment

Who is eligible?

- Automatic WHT exemption on interest and related payments made in respect of loans obtained to finance the purchase or construction of ships
 - MSI-ACIE; and
 - MSI-ACIE (Local ASPV).
- The applicant needs to submit a self-declaration form within specified timeframe for the automatic withholding tax exemption to apply.

Goods and service tax (GST)

- The standard rate for GST is currently 7%.
- With regard to the shipping industry, supplies that qualify for zero-rating relief (i.e., goods and services tax (GST) at 0%) for certain services
- With effect from 1 October 2011, the Approved Marine Customer Scheme (AMCS) was introduced to further ease compliance for businesses procuring goods for use or installation on internationally bound commercial ships. Under the scheme, approved businesses in the shipping and marine industries are eligible to purchase or rent goods at 0% GST. The documentary requirements imposed on suppliers making these zero-rated supplies to these approved businesses have been simplified as well.

Tax treaties

- Singapore has concluded more than 84 comprehensive double taxation agreements. Each of these agreements contains an article on shipping. Under some of these agreements, a non-resident of Singapore may enjoy full exemption on income derived from qualifying shipping activities. Singapore has also entered into limited treaties relating to income arising from the operation of ships in international traffic with the following jurisdictions:
 - Brazil (covers also income from air transport)
 - Chile
 - Hong Kong (covers also income from air transport)
 - United States of America (covers also income from air transport)
- Generally, the shipping article of a tax treaty ensures that profits arising from international traffic will be taxed in the jurisdiction where the enterprise operating the ships is resident.
- The tax residency of a Singapore company is determined by the location where the control and management of the business are exercised. This is generally the place where the board of directors normally holds its meetings, unless it is clearly stated that the control and management are exercised in some other manner. However, please note that the Singapore tax authorities will scrutinise whether the control and management of the business is indeed exercised in Singapore, especially in the post-BEPS environment.

Important Message

The information contained in this document is of a general nature only. It is not meant to be comprehensive and does not constitute the rendering of legal, tax or other professional advice or service by PricewaterhouseCoopers Limited or any other entity within the PwC network. Before taking any action, please ensure that you obtain advice specific to your circumstances from your professional advisors.

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About the Financial Services Development Council

The Hong Kong SAR Government announced in January 2013 the establishment of the Financial Services Development Council (FSDC) as a high-level and cross-sector platform to engage the industry and formulate proposals to promote the further development of Hong Kong's financial services industry and map out the strategic direction for development. The FSDC advises the Government on areas related to diversifying the financial services industry, enhancing Hong Kong's position and functions as an international financial centre of our country and in the region, and further consolidating our competitiveness through leveraging the Mainland to become more global.

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