

THE HONG KONG ASSOCIATION OF BANKS

14 October 2005

By post & fax: 2869 6794

Ms. May Leung
Clerk to Bills Committee
Legislative Council Secretariat
3rd Floor Citibank Tower
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Dear Ms. Leung

Bills Committee on Revenue (Profits Tax Exemption for Offshore Funds) Bill 2005 (Offshore Funds Bill)

We refer to your letter dated 13 September 2005 with respect to the above captioned matter. We are pleased to submit our comments on the Offshore Funds Bill in light of and based on the Offshore Funds Bill - Supplementary Notes/Response to Industry Concerns (Supplementary Notes) attached to the Financial Services and the Treasury Bureau's letter dated 4 October 2005.

As an overview, HKAB is supportive of the concept behind the introduction of the Offshore Funds Bill, that is, to exempt offshore funds from profits tax. However, the technical wordings for and certain aspects of the legislation are complex, and therefore, in order to achieve clarity with respect to the objective of the Offshore Funds Bill, HKAB recommends that certain clarifications and amendments are made with respect to the relevant provisions in the Offshore Funds Bill. The major recommendations are:

1. Definition of “central management and control”

The exemption only applies to non-residents of Hong Kong. Non-individual residents are regarded as non-residents where their central management and control are exercised outside Hong Kong.

The determination of “central management and control” is difficult and complex. As such, the Hong Kong Inland Revenue Department (IRD) has noted in the Supplementary Notes that it considers that the “central management and control of a company refers to the highest level of control of the business of the company”,

provided examples of such determination in Annex A and has undertaken to clarify matters in a Departmental Interpretation and Practice Note (DIPN).

To provide certainty and clarity as to who does qualify for the exemption under the Offshore Funds Bill, HKAB recommends the IRD issues the DIPN to clarify the definition of “central control and management” and to include Annex A of the Supplementary Notes in the DIPN.

2. Extending type and nature of transactions qualifying for the exemption

As currently drafted, only certain transactions, ie. dealing in securities, dealing in futures contracts and leveraged foreign exchange trading defined in the Securities and Futures Ordinance (SFO), qualify for the exemption. The SFO transactions listed may not be wide enough to cover all relevant transactions that may be undertaken by the offshore funds. For example, borrowing and lending money (including participation as lender in syndicated loans), spot foreign exchange transactions, transactions relating to commodities that can be physically settled and derivatives on derivatives (depending on the terms of the transaction) are not included in the SFO (as the purpose of the SFO is to regulate certain securities and futures transactions only).

In response, the IRD has noted that it is prepared to move a CSA to introduce new schedules to expand the scope of qualified transactions and expand the meaning of “securities” in the context of the Offshore Funds Bill, and will work closely with the industry to ensure that the new scheme is practical and workable. HKAB supports the IRD’s proposal.

3. Extending the requirement of specified persons qualifying for the exemption

The IRD has noted that it is prepared to move a CSA to expand the scope of “specified persons” such that a qualified transaction “carried through” any licensed corporation or registered financial institution under the SFO will qualify for the exemption. HKAB supports the IRD’s proposal.

With reference to the term “carried through” in the draft legislation and the IRD’s proposal, for greater legislative clarity, HKAB recommends that this term be further defined and expanded in the legislation to “entered into with or through or arranged by [specified persons]”.

4. Others

There are other amendments, clarifications and proposals noted by the IRD in the Supplementary Notes. To provide certainty and clarity in the operation of the Offshore Funds Bill, HKAB recommends incorporation of such amendments, clarifications and proposals in a DIPN or through a CSA (as appropriate).

Yours sincerely

Eva Wong
Secretary