

REVENUE (PROFITS TAX EXEMPTION FOR OFFSHORE FUNDS) BILL 2005

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A BILL

To

Amend the Inland Revenue Ordinance to give effect to the proposal to exempt offshore funds from profits tax in the Budget introduced by the Government for the 2003–2004 financial year and to make related amendments.

Enacted by the Legislative Council.

1. Short title

This Ordinance may be cited as the Revenue (Profits Tax Exemption for Offshore Funds) Ordinance 2005.

Inland Revenue Ordinance

2. Sections added

The Inland Revenue Ordinance (Cap. 112) is amended by adding—

**“20AB. Interpretation of sections 20AC, 20AD
and 20AE and Schedule 15**

(1) This section applies to the interpretation of sections 20AC, 20AD and 20AE and Schedule 15.

(2) In relation to any year of assessment, a person is to be regarded as a resident person if—

(a) where the person is a natural person who is not a trustee of a trust estate, the person—

(i) ordinarily resides in Hong Kong in that year of assessment; or

- (ii) stays in Hong Kong for a period or a number of periods amounting to more than 180 days during that year of assessment or for a period or a number of periods amounting to more than 300 days in 2 consecutive years of assessment one of which is that year of assessment;
 - (b) where the person is a corporation that is not a trustee of a trust estate, the central management and control of the corporation is exercised in Hong Kong in that year of assessment;
 - (c) where the person is a partnership that is not a trustee of a trust estate, the central management and control of the partnership is exercised in Hong Kong in that year of assessment; or
 - (d) where the person is a trustee of a trust estate, the central management and control of the trust estate is exercised in Hong Kong in that year of assessment.
- (3) In relation to any year of assessment, a person is a non-resident person if he is not a resident person in relation to that year of assessment.
- (4) A person is to be regarded as having a direct beneficial interest in another person if—
- (a) where the other person is a corporation that is not a trustee of a trust estate, the person holds any of the issued share capital (however described) of the corporation;
 - (b) where the other person is a partnership that is not a trustee of a trust estate, the person, as a partner in the partnership, is entitled to any of the profits of the partnership; or
 - (c) where the other person is a trustee of a trust estate, the person—
 - (i) benefits under the trust estate; or
 - (ii) not being a trustee of the trust estate or, where the trustee is a corporation, a director of the trustee, is able or might reasonably be expected to be able to control the activities of the trust estate or the application of its corpus or income, otherwise than through another person (“interposed person”).
- (5) A person (“the first person”) is to be regarded as having an indirect beneficial interest in another person (“the second person”) if—
- (a) where the second person is a corporation that is not a trustee of a trust estate, the first person is interested in any of the issued share capital (however described) of the corporation;

- (b) where the second person is a partnership that is not a trustee of a trust estate, the first person is entitled to any of the profits of the partnership; or
- (c) where the second person is a trustee of a trust estate, the first person—
 - (i) benefits under the trust estate; or
 - (ii) not being a trustee of the trust estate or, where the trustee is a corporation, a director of the trustee, is able or might reasonably be expected to be able to control the activities of the trust estate or the application of its corpus or income,

through another person (“interposed person”) or through a series of 2 or more interposed persons who is or are related to the first person and the second person in the manner described in subsections (6) and (7).

(6) Where there is one interposed person—

- (a) the first person has a direct beneficial interest in the interposed person; and
- (b) the interposed person has a direct beneficial interest in the second person.

(7) Where there is a series of 2 or more interposed persons—

- (a) the first person has a direct beneficial interest in the first interposed person in the series;
- (b) each interposed person (other than the last interposed person) in the series has a direct beneficial interest in the next interposed person in the series; and
- (c) the last interposed person in the series has a direct beneficial interest in the second person.

(8) A reference to an entitlement to the profits of a partnership is, in the case where the partners in a partnership are not entitled to its profits but are only entitled to a distribution of its assets upon its dissolution, to be construed as a reference to an entitlement to a distribution of the assets of the partnership upon its dissolution.

20AC. Certain profits of non-resident persons exempt from tax

(1) Subject to subsections (5) and (6), a non-resident person is exempt from tax chargeable under this Part in respect of his profits for any year of assessment commencing on or after 1 April 1996 from—

- (a) transactions falling within subsection (2), (3) or (4) that are carried out in that year of assessment; and

- (b) transactions carried out in that year of assessment that are incidental to the carrying out of the transactions referred to in paragraph (a).
- (2) A transaction falls within this subsection if—
 - (a) the transaction constitutes a dealing in securities within the meaning of paragraph (a) or (b) of the definition of “dealing in securities” in Part 2 of Schedule 5 to the Securities and Futures Ordinance (Cap. 571); and
 - (b) the transaction was carried out through—
 - (i) a corporation licensed under Part V of that Ordinance to carry on a business in dealing in securities within the meaning of Part 2 of Schedule 5 to that Ordinance;
 - (ii) an authorized financial institution registered under Part V of that Ordinance for carrying on such a business;
 - (iii) a person authorized under section 95(2) of that Ordinance to provide automated trading services; or
 - (iv) a person falling within the description of paragraph (xiv) of the definition of “dealing in securities” in Part 2 of Schedule 5 to that Ordinance.
- (3) A transaction falls within this subsection if—
 - (a) the transaction constitutes a dealing in futures contracts within the meaning of paragraph (a), (b) or (c) of the definition of “dealing in futures contracts” in Part 2 of Schedule 5 to the Securities and Futures Ordinance (Cap. 571); and
 - (b) the transaction was carried out through—
 - (i) a corporation licensed under Part V of that Ordinance to carry on a business in dealing in futures contracts within the meaning of Part 2 of Schedule 5 to that Ordinance;
 - (ii) an authorized financial institution registered under Part V of that Ordinance for carrying on such a business;
 - (iii) a person authorized under section 95(2) of that Ordinance to provide automated trading services; or
 - (iv) a person falling within the description of paragraph (vi) of the definition of “dealing in futures contracts” in Part 2 of Schedule 5 to that Ordinance.

- (4) A transaction falls within this subsection if—
- (a) the transaction constitutes leveraged foreign exchange trading within the meaning of paragraph (a), (b) or (c) of the definition of “leveraged foreign exchange trading” in Part 2 of Schedule 5 to the Securities and Futures Ordinance (Cap. 571); and
 - (b) the transaction was carried out through—
 - (i) a corporation licensed under Part V of that Ordinance to carry on a business in leveraged foreign exchange trading within the meaning of Part 2 of Schedule 5 to that Ordinance; or
 - (ii) a person who performs any act for or in connection with any contract or arrangement or a proposed contract or arrangement falling within the description of paragraph (vi), (viii), (ix) or (xii) of the definition of “leveraged foreign exchange trading” in Part 2 of Schedule 5 to that Ordinance.

(5) Subsection (1) does not apply to a non-resident person in a year of assessment if, at any time in that year of assessment, the person carries on any trade, profession or business in Hong Kong involving any transaction other than a transaction referred to in that subsection.

(6) Subsection (1)(b) does not apply to a non-resident person in a year of assessment if, in that year of assessment, his trading receipts from the incidental transactions referred to in that subsection exceed 5% of the total trading receipts from the transactions referred to in subsection (1)(a) and (b).

20AD. Loss from transactions referred to in section 20AC(1) not available for set off

Notwithstanding anything in this Part, any loss sustained by a non-resident person from a transaction referred to in section 20AC(1) in a year of assessment in which he has not at any time carried on any trade, profession or business in Hong Kong involving any transaction other than a transaction referred to in that section is not available for set off against any of his assessable profits.

20AE. Assessable profits of non-resident persons regarded as assessable profits of resident persons

(1) Where, at any time in the year of assessment in which the Revenue (Profits Tax Exemption for Offshore Funds) Ordinance 2005 (of 2005) commences or in any subsequent year of assessment, a resident person has a direct or indirect beneficial interest in a non-resident person to the extent set out in subsection (2) and the non-resident person is exempt from tax under section 20AC, the assessable profits of the non-resident person that would have been chargeable to tax under this Part but for that section for the period during which the resident person has such a beneficial interest in the non-resident person are to be regarded as the assessable profits arising in or derived from Hong Kong of the resident person for that year of assessment from a trade, profession or business carried on by the resident person in Hong Kong.

(2) The extent of a resident person's beneficial interest in a non-resident person referred to in subsection (1) is that the resident person, either alone or jointly with any of his associates (whether a resident person or not)—

- (a) where the non-resident person is a corporation that is not a trustee of a trust estate, holds or is interested in not less than 30% of the issued share capital (however described) of the corporation;
- (b) where the non-resident person is a partnership that is not a trustee of a trust estate, is entitled to not less than 30% of the profits of the partnership; or
- (c) where the non-resident person is a trustee of a trust estate, is interested in not less than 30% in value of the trust estate.

(3) Where, at any time in the year of assessment in which the Revenue (Profits Tax Exemption for Offshore Funds) Ordinance 2005 (of 2005) commences or in any subsequent year of assessment, a resident person has a direct or indirect beneficial interest in a non-resident person who is exempt from tax under section 20AC and the non-resident person is an associate of the resident person, the assessable profits of the non-resident person that would have been chargeable to tax under this Part but for that section for the period during which the resident person has such a beneficial interest in the non-resident person are to be regarded as the assessable profits arising in or derived from Hong Kong of the resident person for that year of assessment from a trade, profession or business carried on by the resident person in Hong Kong.

(4) Subsections (1) and (3) apply in relation to a resident person irrespective of whether the person has received, or will receive, directly or indirectly, from the non-resident person concerned any money or other property representing the profits of the non-resident person for the relevant year of assessment.

(5) A resident person who has a direct or indirect beneficial interest in a trustee of a trust estate by reason of the fact that he is able or might reasonably be expected to be able to control the activities of the trust estate or the application of its corpus or income is, for the purposes of this section, to be regarded as being interested in 100% in value of the trust estate.

(6) The extent of a resident person's beneficial interest in a non-resident person is to be determined in accordance with the provisions in Part 2 of Schedule 15.

(7) The amount regarded as the assessable profits of a resident person for a year of assessment under subsection (1) or (3) is to be ascertained in accordance with the provisions in Schedule 15.

(8) Subsection (1) or (3) does not apply in relation to a resident person who has a direct or indirect beneficial interest in a non-resident person if the Commissioner is satisfied that beneficial interests in the non-resident person are bona fide widely held.

(9) Where a resident person is liable to tax under subsection (1) or (3) in respect of the profits of a non-resident person by reason of his having an indirect beneficial interest in the non-resident person through an interposed person or through a series of 2 or more interposed persons, if the interposed person or any of the interposed persons is a resident person who is also liable to tax under that subsection in respect of the same profits, the first-mentioned resident person is discharged from his liability to tax under that subsection in respect of those profits.

(10) In this section—

“associate” (相聯者), in relation to a person, means—

(a) where the person is a natural person—

- (i) a relative of the person;
- (ii) a partner of the person and any relative of that partner;
- (iii) a partnership in which the person is a partner;
- (iv) any corporation controlled by the person, by a partner of the person or by a partnership in which the person is a partner;
- (v) any director or principal officer of a corporation referred to in subparagraph (iv);

(b) where the person is a corporation—

- (i) any associated corporation;

- (ii) any person who controls the corporation and any partner of such person, and, where either such person is a natural person, any relative of such person;
- (iii) any director or principal officer of the corporation or of any associated corporation and any relative of any such director or officer;
- (iv) any partner of the corporation and, where such partner is a natural person, any relative of such partner;
- (c) where the person is a partnership—
 - (i) any partner of the partnership and where such partner is a partnership any partner of that partnership, any partner with the partnership in any other partnership and where such partner is a partnership any partner of that partnership and where any partner of, or with, or in any of the partnerships mentioned in this subparagraph is a natural person, any relative of such partner;
 - (ii) any corporation controlled by the partnership or by any partner of the partnership or, where such a partner is a natural person, any relative of such partner;
 - (iii) any corporation of which any partner of the partnership is a director or principal officer;
 - (iv) any director or principal officer of a corporation referred to in subparagraph (ii);

“associated corporation” (相聯法團), in relation to a person, means—

- (a) a corporation over which the person has control;
- (b) a corporation which has control over such a person, being a corporation; or
- (c) a corporation which is under the control of the same person, being a corporation;

“control” (控制), in relation to a corporation, means the power of a person to secure—

- (a) by means of the holding of shares or the possession of voting power in or in relation to that or any other corporation; or
- (b) by virtue of any powers conferred by the articles of association or other document regulating that or any other corporation,

that the affairs of the first-mentioned corporation are conducted in accordance with the wishes of that person;

“principal officer” (主要職員), in relation to a corporation, means—

- (a) a person employed by the corporation who, either alone or jointly with one or more other persons, is responsible under the immediate authority of the directors for the conduct of the business of the corporation; or
- (b) a person so employed who, under the immediate authority of a director of the corporation or a person to whom paragraph (a) applies, exercises managerial functions in respect of the corporation;

“relative” (親屬), in relation to a person, means the spouse, parent, child, brother or sister of the person, and, in deducing such a relationship, an adopted child is to be regarded as a child both of the natural parents and the adopting parent and a step child as the child of both the natural parents and of any step parent.

(11) Notwithstanding anything in subsection (1) or (3), a resident person who is chargeable to tax in respect of any sum regarded under that subsection as his assessable profits for the year of assessment in which the Revenue (Profits Tax Exemption for Offshore Funds) Ordinance 2005 (of 2005) commences is, in relation to those profits, only liable to pay tax in respect of the part of those profits arising on or after the commencement of that Ordinance for that year of assessment.”.

3. Section added

The following is added—

“70AB. Revision of assessment due to commencement of section 2 of Revenue (Profits Tax Exemption for Offshore Funds) Ordinance 2005

(1) Notwithstanding any other provisions of this Ordinance, if, upon application by a person in respect of a year of assessment (“the relevant year”) that expires before the date of commencement of section 2 of the Revenue (Profits Tax Exemption for Offshore Funds) Ordinance 2005 (of 2005) made within 12 months after that date, or within 6 years after the end of the relevant year, whichever is the later, it is established to the satisfaction of an assessor that the tax charged for the relevant year exceeds the amount that the person would have had to pay had that section been in force, the assessor shall revise the assessment for the relevant year.

(2) Where an assessor refuses to revise an assessment in accordance with an application made under this section, he shall give notice of the refusal in writing to the person who made the application and the person thereupon has the same rights of objection and appeal under this Part as if the notice of refusal were a notice of assessment.”.

4. Schedule 15 added

The following is added—

“SCHEDULE 15 [ss. 20AB & 20AE]

PROVISIONS FOR ASCERTAINING AMOUNT OF ASSESSABLE PROFITS OF
RESIDENT PERSON UNDER SECTION 20AE OF THIS ORDINANCE

PART 1

1. The amount regarded as the assessable profits of a resident person for a year of assessment is the total sum arrived at by adding up the assessable profits of the non-resident person that would have been chargeable to tax under Part IV of this Ordinance but for section 20AC of this Ordinance (“exempt profits”) for each day in the period in that year of assessment during which the resident person has a direct or indirect beneficial interest in the non-resident person.
2. For the purposes of section 1, the exempt profits of a non-resident person for a particular day in a year of assessment are to be ascertained in accordance with the following formula—

$$A = \frac{B \times C}{D}$$

- where:
- A means the exempt profits of the non-resident person for a particular day in a year of assessment;
 - B means the extent of the resident person’s beneficial interest in the non-resident person on the particular day, expressed as a percentage determined in accordance with Part 2;
 - C means the exempt profits of the non-resident person for the accounting period of the non-resident person in which the particular day falls;
 - D means the total number of days in the accounting period of the non-resident person in which the particular day falls.

PART 2

1. Where a resident person has a direct beneficial interest in a non-resident person, the extent of the beneficial interest of the resident person in the non-resident person is—

- (a) where the non-resident person is a corporation that is not a trustee of a trust estate, the percentage of the issued share capital (however described) of the corporation held by the resident person;
 - (b) where the non-resident person is a partnership that is not a trustee of a trust estate, the percentage of the profits of the partnership to which the resident person is entitled; or
 - (c) where the non-resident person is a trustee of a trust estate, the percentage in value of the trust estate in which the resident person is interested.
- 2. Where a resident person has an indirect beneficial interest in a non-resident person, the extent of the beneficial interest of the resident person in the non-resident person is—
 - (a) where there is one interposed person, the percentage arrived at by multiplying the percentage representing the extent of the beneficial interest of the resident person in the interposed person by the percentage representing the extent of the beneficial interest of the interposed person in the non-resident person; or
 - (b) where there is a series of 2 or more interposed persons, the percentage arrived at by multiplying the percentage representing the extent of the beneficial interest of the resident person in the first interposed person in the series by—
 - (i) the percentage representing the extent of the beneficial interest of each interposed person (other than the last interposed person) in the series in the next interposed person in the series; and
 - (ii) the percentage representing the extent of the beneficial interest of the last interposed person in the series in the non-resident person.
- 3. For the purposes of section 2—
 - (a) section 1 applies in determining the extent of the beneficial interest of a resident person in an interposed person as if references to a non-resident person in that section were references to an interposed person;
 - (b) section 1 applies in determining the extent of the beneficial interest of an interposed person in a non-resident person as if references to a resident person in that section were references to an interposed person;

- (c) section 1 applies in determining the extent of the beneficial interest of an interposed person (first-mentioned interposed person) in another interposed person (second-mentioned interposed person) as if—
- (i) references to a resident person in that section were references to the first-mentioned interposed person; and
 - (ii) references to a non-resident person in that section were references to the second-mentioned interposed person.”.

Explanatory Memorandum

The main purpose of this Bill is to give effect to the proposal to exempt offshore funds from profits tax in the Budget introduced by the Government for the 2003–2004 financial year.

2. Clause 2 adds 4 new sections, being sections 20AB to 20AE, to the Inland Revenue Ordinance (Cap. 112) (“the principal Ordinance”). The major provisions of those sections are explained below.

3. The proposed section 20AB contains provisions for use in the interpretation of the proposed sections 20AC to 20AE and Schedule 15 added by clause 4. The proposed section 20AB(2) and (3) deals with the determination of the residence of individuals, corporations, partnerships and trustees. The proposed section 20AB(4) to (7) explains when a person has a direct or indirect beneficial interest in another person.

4. The proposed section 20AC(1) provides that a non-resident person is exempt from profits tax in respect of his profits from 2 kinds of specified transactions. The exemption applies in relation to a year of assessment commencing on or after 1 April 1996. The proposed section 20AC(2), (3) and (4) describes the first kind of those transactions. In short, to qualify for the exemption, the person’s profits must come from a transaction that constitutes a dealing in securities, a dealing in futures contracts or leveraged foreign exchange trading and the transaction must be carried out through specified persons. The second kind of transaction is a transaction that is incidental to the carrying out of the first kind of transaction.

5. The proposed section 20AC(5) provides that a non-resident person will lose the entire exemption in a year of assessment if he carries on in Hong Kong in that year of assessment any business that involves any transaction other than the specified transactions. The proposed section 20AC(6) provides that if a non-resident person's trading receipts from the second kind of transaction in a year of assessment exceed 5% of the total trading receipts from both kinds of transactions in that year of assessment, the exemption in respect of the profits from the second kind of transaction will be lost.

6. The proposed section 20AD provides that in certain circumstances a loss arising from the specified transactions in a year of assessment cannot be used to set off assessable profits.

7. The proposed section 20AE(1) and (3) provides that in certain circumstances the assessable profits of a non-resident person who is exempt from profits tax under the proposed section 20AC ("exempt person") are to be regarded as the assessable profits of a resident person. It applies in relation to the year of assessment in which the Bill when enacted commences and to subsequent years of assessment. The provisions will be invoked in the following circumstances—

- (a) where a resident person has a direct or indirect beneficial interest in an exempt person and the interest reaches a specified threshold; and
- (b) where a resident person has a direct or indirect beneficial interest in an exempt person and the exempt person is the resident person's associate.

8. The specified threshold referred to in paragraph 7(a) is, if the exempt person is a corporation, an interest in not less than 30% of its issued share capital, or if the exempt person is a partnership, an interest in not less than 30% of its profits, or if the exempt person is a trustee, an interest in not less than 30% in value of the relevant trust estate.

9. The proposed section 20AE(8) provides that the proposed section 20AE(1) or (3) does not apply in relation to a resident person if the Commissioner of Inland Revenue is satisfied that beneficial interests in the relevant exempt person are bona fide widely held.

10. Where a resident person has a beneficial interest in a non-resident person through an interposed person or through a series of 2 or more interposed persons, if the interposed person or any of the interposed persons is a resident person, then more than one resident person will be liable to profits tax under the proposed section 20AE(1) or (3). The proposed section 20AE(9) discharges a resident person from his liability to tax in respect of the profits of a non-resident person that are regarded as the profits of the resident person by reason of such beneficial interest if another resident person through whom he has such beneficial interest is also liable to profits tax in respect of the same profits.

11. The proposed section 20AE(11) provides that a resident person who is liable to profits tax under the proposed section 20AE(1) or (3) for the year of assessment in which the Bill when enacted commences is, in relation to his assessable profits under the proposed section 20AE(1) or (3), only required to pay profits tax in respect of the part of those profits arising on or after the commencement of the Bill when enacted for that year of assessment.

12. Clause 3 adds a new section 70AB to the principal Ordinance. The proposed section makes provision for the revision of an assessment necessitated by the commencement of the exemption provision, that is, the proposed section 20AC, contained in clause 2.

13. Clause 4 adds a new Schedule 15 to the principal Ordinance. The proposed Schedule contains a formula for ascertaining the amount regarded as the assessable profits of a resident person under the proposed section 20AE(1) and (3).