

立法會
Legislative Council

LC Paper No. CB(1)1298/14-15
(These minutes have been seen
by the Administration)

Ref : CB1/BC/5/14

Bills Committee on Inland Revenue (Amendment) Bill 2015

**Minutes of second meeting held on
Tuesday, 19 May 2015, at 4:30 pm
in Conference Room 1 of the Legislative Council Complex**

Members present : Hon Christopher CHEUNG Wah-fung, SBS, JP (Chairman)
Hon CHAN Kam-lam, SBS, JP
Hon Abraham SHEK Lai-him, GBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP
Hon Starry LEE Wai-king, JP
Hon Alan LEONG Kah-kit, SC
Hon NG Leung-sing, SBS, JP
Hon Charles Peter MOK, JP
Hon CHAN Yuen-han, SBS, JP
Hon Kenneth LEUNG
Hon SIN Chung-kai, SBS, JP
Ir Dr Hon LO Wai-kwok, BBS, MH, JP

**Public officers
attending** : Agenda Item I

Financial Services and the Treasury Bureau

Miss Salina YAN
Deputy Secretary (Financial Services) 1

Ms Joyce HO
Principal Assistant Secretary (Financial Services) 1

Inland Revenue Department

Mr CHIU Kwok-kit
Deputy Commissioner of Inland Revenue (Technical)

Miss HUI Chiu-po
Senior Assessor (Research)1

Department of Justice

Ms Mandy NG
Senior Government Counsel

**Attendance by
invitation**

: Agenda Item I

Hong Kong Venture Capital and Private Equity
Association

Mr John LEVACK
Chairman of HKVCA Technical Committee

Clerk in attendance

: Mr Derek LO
Chief Council Secretary (1)5

Staff in attendance

: Ms Vanessa CHENG
Assistant Legal Adviser 5

Miss Rita YUNG
Senior Council Secretary (1)8

Ms Michelle NIEN
Legislative Assistant (1)5

Action

I Meeting with deputations and the Administration

- (LC Paper No. CB(1)849/14-15(01) —List of follow-up actions arising from the discussion at the meeting on 28 April 2015
- LC Paper No. CB(1)849/14-15(02) —Administration's response to issues raised at the meeting on 28 April 2015
- LC Paper No. CB(1)849/14-15(03) —Letter dated 4 May 2015 from Legal Service Division to the Administration
- LC Paper No. CB(1)849/14-15(04) —Administration's response to Legal Service Division's letter dated 4 May 2015)

1.1. The Bills Committee deliberated (Index of proceedings attached at **Appendix**).

2. The Bills Committee received views from the Hong Kong Venture Capital and Private Equity Association attending the meeting and noted the written submissions provided by the following two deputations which did not attend the meeting –

- (a) Joint Liaison Committee on Taxation (LC Paper No. CB(1)849/14-15(06)); and
- (b) The Taxation Institute of Hong Kong (LC Paper No. CB(1)849/14-15(07)).

3. The Chairman requested the Administration to provide a written response to the views and submissions from the deputations.

(Post meeting note: The Administration's response was issued to members vide LC Paper No. CB(1)967/14-15(01) on 9 June 2015.)

4. The Chairman concluded that the Bills Committee had completed scrutiny of the Inland Revenue (Amendment) Bill 2015 ("the Bill") and would submit a report on its deliberations to the House Committee in due course.

5. Members noted that the Administration would advise the Bills Committee on the proposed date for resumption of the Second Reading debate on the Bill in due course.

(Post-meeting note: Members were informed vide LC Paper No. CB(1)908/14-15 issued on 9 June 2015 that the Administration had proposed to resume the Second Reading debate on the Bill at the Council meeting of 8 July 2015.)

II Any other business

6. There being no other business, the meeting ended at 5:48 pm.

Council Business Division 1
Legislative Council Secretariat
8 October 2015

**Proceedings of the second meeting of
the Bills Committee on Inland Revenue (Amendment) Bill 2015
on Tuesday, 19 May 2015, at 4:30 pm
in Conference Room 1 of the Legislative Council Complex**

Time marker	Speaker	Subject(s)	Action required
Agenda Item I – Meeting with deputations and the Administration			
000508– 000739	Chairman	Opening remarks	
000740 – 001423	Mr John LEVACK, Hong Kong Venture Capital and Private Equity Association ("HKVCA")	Presentation of views as set out in submission (LC Paper No. CB(1)849/14-15(05))	
001424 – 001832	Chairman Administration	<p>The Administration's response to deputation's views –</p> <ul style="list-style-type: none"> (a) private equity was an important component of Hong Kong's asset management industry. In terms of the size of capital under management by private equity funds, Hong Kong ranked second in Asia, and there was potential for further growth of the industry in Hong Kong; (b) the proposed profits tax exemption for private equity funds aimed to facilitate the development of the private equity sector, and strengthen Hong Kong's position as a premier international asset management centre; (c) the proposed tax exemption had struck a balance between addressing the calls from the fund industry for providing clear tax exemption to transactions conducted by offshore private equity funds in respect of eligible private companies outside Hong Kong and preventing possible abuse of the exemption for tax avoidance; and (d) by providing clear tax exemption, the proposal would help attract more offshore private equity funds to set up or expand their business in Hong Kong, thereby generating demand for local asset management, investment and advisory services, as well as other relevant professional services. 	

Time marker	Speaker	Subject(s)	Action required
		As requested by the Chairman, the Administration would provide a written response to the views and submissions from the deputations.	The Administration to follow up.
001833 – 002349	Chairman Mr Kenneth LEUNG Mr John LEVACK, HKVCA	<p>Mr Kenneth LEUNG invited views from the deputation on whether there were any suggested improvements to the proposed profits tax exemption.</p> <p>Mr John LEVACK of HKVCA expressed the following views –</p> <p>(a) HKVCA supported the Bill as a positive step to enhance the attractiveness of Hong Kong as a private equity hub and to deepen the engagement for private equity firms already operating in Hong Kong and simplifying their operating structure;</p> <p>(b) to encourage offshore private equity funds to invest in local start-ups, the Administration should consider relaxing the qualifying conditions for the proposed profits tax exemption in respect of offshore funds having investments in Hong Kong-based and offshore private companies. It was suggested that as an investment in local private company by an offshore fund would be subject to profits tax under the existing tax regime, tax exemption should be granted to the remaining qualified investments in offshore private companies by the offshore fund so that these investments would not be 'tainted' by the Hong Kong-based investment; and</p> <p>(c) it was also suggested that the definition of "qualifying funds" be expanded to include some key private equity funding vehicles such as sovereign-wealth funds, Mainland state-owned enterprises and pension funds.</p>	
002350 – 002921	Chairman Mr Charles MOK Mr John LEVACK, HKVCA	Mr Charles MOK invited deputation's views on the concern that the proposed profits tax exemption would in effect encourage private equity funds to invest more in offshore companies at the expense of local companies, in particular the innovation and technology industries and entrepreneurs in Hong Kong.	

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		<p>Mr John LEVACK of HKVCA expressed the following views –</p> <ul style="list-style-type: none"> (a) an offshore private equity fund would usually invest in local private companies through the use of special structuring arrangements such that the investment would not be subject to Hong Kong profits tax; and (b) by providing clear tax exemption, the Bill would simplify the operating structure for investing in offshore private companies (but not local private companies) by offshore private equity funds in Hong Kong. 	
002922 – 003440	Chairman Mr Kenneth LEUNG Administration	<p>Mr Kenneth LEUNG enquired about the rationale for not accepting the fund industry's suggestion to extend profits tax exemption to offshore private equity funds for a certain proportion of their investments in local companies.</p> <p>The Administration responded that –</p> <ul style="list-style-type: none"> (a) if tax exemption was granted to offshore private equity funds investing in local private companies, it would make it easier for local companies to simply convert their taxable profits to non-taxable income via an offshore fund structure. This would have implications on Government's tax revenue; (b) in the Inland Revenue Ordinance (Cap. 112), the definition of "non-resident persons" included individuals, corporations, partnerships and trustees of trust estates. In view of the various forms of entities concerned, it would be difficult to devise an exemption regime which would address the fund industry's request while effectively preventing abuse of the exemption for tax avoidance; and (c) the current proposal of tax exemption had struck a balance between addressing the calls from the fund industry for providing clear tax exemption to transactions conducted by offshore private equity funds in respect of eligible private companies outside Hong Kong and preventing possible abuse of the exemption. 	

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003441 – 004016	Chairman Mr Charles MOK Mr John LEVACK, HKVCA Administration	<p>Mr Charles MOK enquired whether the various structuring arrangements used by offshore private equity funds to invest in local private companies constituted a loophole in the proposed profits tax exemption.</p> <p>Mr John LEVACK of HKVCA held the view that profits from disposal of investments in private companies which had been held by private equity funds for the medium term, typically three to seven years, should be regarded as capital gains and should not be chargeable to profits tax.</p> <p>The Administration responded that it would not be appropriate to generalize that an offshore private equity fund using special structuring arrangements to invest in local private companies would or would not constitute an abuse of the profits tax exemption for tax avoidance. The facts and details of each case, including how the terms of agreement were drafted, how the structuring was being done etc., should be carefully examined before coming to a conclusion.</p>	
004017 – 004734	Chairman Mr Kenneth LEUNG Administration Mr John LEVACK, HKVCA	<p>Mr Kenneth LEUNG expressed the following views –</p> <p>(a) he was not convinced that if tax exemption was granted to offshore private equity funds investing in local private companies, it would increase the possibility of onshore funds seeking to redomicile to other jurisdictions, thereby causing implications on Government's tax revenue; and</p> <p>(b) the Administration should consider, in the next stage of its work, extending the profits tax exemption to offshore private equity funds which invested passively in local start-ups, so as to promote the development of start-ups in Hong Kong, and help diversify Hong Kong's economic base.</p> <p>The Administration responded that –</p> <p>(a) extending profits tax exemption to investments in local private companies would require much broader and in-depth policy considerations;</p> <p>(b) the current proposal was a first step of a more far-reaching change, if considered desirable in future; and</p>	

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		<p>(c) the Administration was committed to enhancing providing hardware and software support and improving the ecosystem for local start-ups and technological enterprises to enable local industries to diversify.</p> <p>Mr John LEVACK of HKVCA expressed that the fund industry appreciated the issues and considerations involved in extending the tax exemption to investments in local private companies. The industry welcomed the current proposal as a first step and would continue to communicate with the Administration in respect of further extension in the future.</p>	
004735 – 004826	Chairman	Conclusion of meeting with deputation	
004827 – 005012	Chairman Administration	<p>Briefing on the Administration's response to issues raised at the meeting on 28 April 2015 (LC Paper No. CB(1)849/14-15(02)).</p> <p>Members raised no question.</p>	
005013 – 005612	Chairman Mr Kenneth LEUNG Administration	<p>Mr Kenneth LEUNG sought elaboration on the Administration's response to Legal Service Division's letter dated 4 May 2015 (LC Paper No. CB(1)849/14-15(04)) in relation to the deeming provisions in respect of assessable profits of special purpose vehicles ("SPVs") held by non-resident persons under the new section 20AF(7), and in particular, how the requirement of "bona fide widely held" in the section should be interpreted.</p> <p>The Administration responded that –</p> <p>(a) to prevent abuse or round-tripping by onshore or resident entities disguised as offshore funds, the existing deeming provisions in the Inland Revenue Ordinance would equally apply to offshore private equity funds;</p> <p>(b) a resident person (alone or jointly with his associates) holding a beneficial interest of 30% or more in a tax-exempt private equity fund would be deemed to have derived assessable profits in respect of profits earned by the fund from specified transactions and incidental transactions in Hong Kong;</p>	

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		<p>(c) the proposed section 20AF(7) served as safe harbour within which the deeming provisions would not apply if the Commissioner of Inland Revenue was satisfied that beneficial interests in the offshore private equity fund were bona fide widely held; and</p> <p>(d) Inland Revenue Department ("IRD") interpreted the term "bona fide widely held" as follows –</p> <p>(i) during the year of assessment in question, at no time did fewer than 50 persons held all of the units or shares in the offshore fund; and</p> <p>(ii) at no time during the year did fewer than 21 persons held units or shares that entitled the holders, directly or indirectly, to 75%, or more, of the income or property of the non-resident fund.</p> <p>Mr Kenneth LEUNG expressed doubt whether the above safe harbour would in fact increase the possibility of abuse or round-tripping by resident entities disguised as offshore funds.</p> <p>On the use of the term "bona fide widely held", the Administration further advised that –</p> <p>(a) a resident person holding a small interest in an offshore fund might have difficulty in ascertaining the weighting of his interests in the fund when reporting deemed profits to IRD; and</p> <p>(b) where the benchmark figures mentioned in paragraph (d) above were not met, IRD would accept in practice that the "bona fide widely held" requirement had been satisfied if it was clear from the constitutive documents of the non-resident fund and other relevant materials that it was established with a view to wide public participation and that genuine efforts had been made with the aim of achieving that objective, i.e. there was nothing to suggest that the non-resident fund was intended to be a closely held investment vehicle.</p>	

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<p><i>Clause-by-clause examination of the Bill</i> [The Bill (LC Paper No. CB(3)542/14-15)] [Marked-up copy of the Bill prepared by the Legal Service Division (LC Paper No. CB(1)770/14-15(01))]</p>			
005613 – 005853	Chairman Administration	<p><u>Clause 3 – to amend section 20AB (interpretation of sections 20AC, 20AD and 20 AE and Schedule 15)</u></p> <p>Members raised no question.</p>	
005854 – 010248	Chairman Mr Kenneth LEUNG Administration	<p><u>Clause 4 – to amend section 20AC (certain profits of non-resident persons exempt from tax)</u></p> <p><i>Proposed section 20AC(2)</i></p> <p>In response to Mr Kenneth LEUNG's enquiry about the two qualifying conditions for tax exemption as set out in the proposed section 20AC(2)(b), the Administration advised that –</p> <p>(a) the first condition ("the transaction has been carried out through or arranged by a specified person") was an existing provision in the Inland Revenue Ordinance applicable to offshore funds which were managed by corporations licensed under the Securities and Futures Ordinance (Cap. 571) to carry on a business of regulated activities; and</p> <p>(b) the proposed condition ("the non-resident person is a qualifying fund") was added to allow offshore private equity funds which were not managed by licensees of the Securities and Futures Commission to also enjoy profits tax exemption.</p>	
010249 – 010922	Chairman Mr Kenneth LEUNG Assistant Legal Adviser 5 ("ALA5") Administration	<p><u>Clause 5 – to add sections 20ACA and 20ACB</u></p> <p><i>Proposed section 20ACA – Certain profits of special purpose vehicles exempt from payment of tax</i></p> <p>Mr Kenneth LEUNG enquired about the acceptable legal forms of an SPV.</p> <p>The Administration responded that –</p> <p>(a) an SPV, which was a purpose-built structuring tool of a private equity fund, could be a corporation, partnership, trustee of a trust estate or any other entity incorporated, registered or</p>	

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		<p>appointed in or outside Hong Kong; and</p> <p>(b) "any other entity" was included in the definition of SPV so as to facilitate the use of various forms of SPV, such as a contractual arrangement, by the industry.</p> <p>Regarding the qualifying conditions for an excepted private company, ALA5 sought clarification as to how the value of the assets of an excepted private company was determined when considering whether 10% threshold was reached.</p> <p>The Administration responded that –</p> <p>(a) when determining the value of assets of an excepted private company, IRD would examine the company's balance sheet and other accounting records, and both the assets in Hong Kong and overseas would be taken into account; and</p> <p>(b) if an excepted private company held (whether directly or indirectly) share capital (however described) in one or more private companies with direct or indirect holding of immovable property in Hong Kong, the aggregate value of the holding of the share capital should not be more than 10% of the value of its own assets.</p>	
010923 – 011117	Chairman Mr Kenneth LEUNG Administration	<p><u>Clause 5 – to add sections 20ACA and 20ACB</u></p> <p><i>Proposed section 20ACB – Permanent establishment of private company</i></p> <p>Mr Kenneth LEUNG enquired whether IRD would issue Departmental Interpretation and Practice Notes ("DIPN") in relation to the determination of a permanent establishment of a private company, in particular on the meaning of "business activities of a purely preparatory or auxiliary character".</p> <p>The Administration responded that –</p> <p>(a) it had made reference to the terms used by the Organization for Economic Co-operation and Development when defining a permanent establishment; and</p>	

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		(b) IRD would issue a DIPN in relation to the interpretation of the legislation, if necessary, after the enactment of the Bill.	
011118 – 011140	Chairman ALA5 Administration	<p><u>Clause 5 – to add sections 20ACA and 20ACB</u></p> <p><i>Proposed section 20ACA – Certain profits of special purpose vehicles exempt from payment of tax</i></p> <p>ALA5 sought clarification on whether the ownership of an SPV by a non-resident person included direct and indirect ownership.</p> <p>The Administration confirmed that an SPV could be a corporation, partnership, trustee of a trust estate or any other entity that was wholly or partially owned (whether directly or indirectly) by a non-resident person.</p>	
011141 – 011525	Chairman Administration	<p><u>Clause 6 – to substitute section 20AD</u></p> <p><u>Clause 7 – to amend section 20AE (assessable profits of non-resident persons regarded as assessable profits of resident persons)</u></p> <p><u>Clause 8 – to add section 20AF</u></p> <p><u>Clause 9 – to amend Schedule 15 (provisions for ascertaining amount of assessable profits of resident person under section 20AE of this Ordinance)</u></p> <p><u>Clause 10 – to add Schedule 15A</u></p> <p><u>Clause 11 – to amend Schedule 16 (specified transactions)</u></p> <p><u>Clause 12 – to amend Schedule 17A (specified alternative bond scheme and its tax treatment)</u></p> <p>Members raised no question on clauses 6 to 12.</p>	
011526 – 011727	Chairman ALA5 Administration	<p><u>Clause 5 – to add sections 20ACA and 20ACB</u></p> <p><i>Proposed section 20ACA – Certain profits of special purpose vehicles exempt from payment of tax</i></p> <p>ALA5 enquired how the Administration would determine that a private company incorporated outside Hong Kong was one that was not allowed to raise</p>	

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		<p>funds from the public as it was so required in the proposed definition of "private company".</p> <p>The Administration explained that when determining whether a company incorporated outside Hong Kong fell under the definition of "private company", IRD would examine whether it was disallowed by local laws or authorities to issue an invitation to the public to subscribe for any shares or debenture of the company and the private company's articles of association, if required by local laws, would also be examined.</p>	
011728 – 011856	Chairman Administration	<p>The Bills Committee completed the scrutiny of the Bill.</p> <p>Closing remarks</p>	