Bills Committee on Inland Revenue (Amendment) Bill 2015
Responses from the Administration to comments given by deputations to the Bills Committee

Comments	The Administration's responses
Conditions of "Excepted Private Company" *Organizations: Hong Kong Venture Capital and Private Equity Association ("HKVCA"), Joint Liaison Committee on Taxation ("JLCT") and The Taxation Institute of Hong Kong ("TIHK")*	
1. The restriction that an excepted private company cannot directly or indirectly through a private company it holds, carry on any business in Hong Kong through or from a permanent establishment should be removed. A Hong Kong-based investment by an offshore private equity fund should be subject to the ordinary tax rules and the remaining qualified investments in the fund should still benefit from the exemption.	The policy objective of the current legislative proposal is to promote the further development of Hong Kong's asset management industry. By providing clear tax exemption to transactions conducted by offshore private equity funds in respect of eligible private companies outside Hong Kong, we hope to attract more private equity fund managers to expand their business and conduct asset management activities in Hong Kong. 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 will have implications on Governments' tax revenue and requires further examination.
2. The 10% de minimis threshold for holding Hong Kong real estate (i.e. a portfolio company would be eligible for tax exemption if it held immovable property in Hong Kong, or 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, but the aggregate value of the holding of the property and capital is equivalent to not more than 10% of	The proposed conditions that a portfolio company should meet to be qualified reflect our policy intent to extend the profits tax exemption for offshore funds to include transactions in private companies which do not hold any Hong Kong properties nor carry out any business in Hong Kong. Taking into account the common practices of private equity funds, we propose to provide certain flexibility so that the portfolio companies may carry on business activities of a purely preparatory or auxiliary

the value of its own assets) might be too low.	character and may hold immovable property or share capital in other private companies with immovable property in Hong Kong but the aggregate value of the holding of the property and capital should not exceed 10% of the value of the total assets of the private company. The proposal is formulated in consultation with the industry. Any further relaxation of the conditions may create loopholes against tax avoidance as it would be made easier for companies to simply convert their taxable profits to non-taxable income via an offshore fund structure.
3. The definition of "excepted private company" needs refinement to clarify the policy intent and the operational practices.	The Inland Revenue Department ("IRD") will provide details of administrative practice in its Departmental Interpretation and Practice Notes ("DIPN") if necessary.
Conditions of "qualifying fund" *Organizations: HKVCA and JLCT*	
4. The definition of the "qualifying fund" excludes some private equity funding vehicles, such as sovereign wealth funds, state-owned enterprises and pension funds that are single entities ultimately representing many interests.	Sovereign wealth funds, state owned enterprises and pension funds may enjoy tax exemption under section 20AC(1) of the Inland Revenue Ordinance ("IRO") (Cap. 112) in respect of profits derived from the specified transactions carried out through or arranged by a specified person (which include corporations licensed and authorized financial institutions registered under the Securities and Futures Ordinance (Cap. 571)), or under section 26A(1A) of the IRO if they qualify as bona fide widely held investment schemes which comply with the requirements of a supervisory authority within an

	acceptable regulatory regime.
5. The definition of "final closing of sale of interests" contained in the definition of "qualifying fund" is difficult to apply where the company is an open-ended one because such companies will be continuously raising funds. Also, the definition allows for some manipulation because an originator could continually move the relevant time by inviting new subscribers into the fund at any time, thereby moving the reference point of time.	Private equity funds are typically closed-end funds. A closed-end private equity fund by definition has only one final close and would not be re-opened for new capital commitment after final close, or for that matter after asset disposal. The time of "final closing of sale of interests" should be clear from the fund document or prospectus, which form part of a contract agreed at the outset.
Conditions of "special purpose vehicle" ("SPV") *Organizations: TIHK and JLCT*	
6. Section 20ACA of the Bill does not explicitly say that, in relation to the definition of SPV, the condition "owned by a non-resident person" refers to both direct and indirect ownership. Thus, there might be some uncertainty about whether an interposed SPV, which is wholly owned by another SPV being a resident of Hong Kong, is an SPV by definition.	The policy intent is that, under section 20ACA(2) of the Bill, an SPV could be owned directly or indirectly by a non-resident person. In fact, the relevant section does not prohibit indirect holding by the non-resident person in an SPV.
7. The condition that an SPV cannot itself be an excepted private company may create some uncertainty. This would be the case where an overseas incorporated investment holding company is used as an SPV to hold an excepted private company.	We consider it necessary to make clear that an SPV cannot be an excepted private company. Under the Bill, an SPV is not meant to be an excepted private company because the SPV should not carry on any trade or activities except for the purpose of holding, directly or indirectly, and administering one or more excepted private companies.

Technical comments on the definition of "permanent establishment" *Organization: JLCT*	
8. The definition of "permanent establishment" includes a place for the filling of orders (new section 20ACB(2)(b)), but excludes a place (or agent) used for the storage/delivery of goods (new section 20ACB(3)(a)). Essentially, these are the same functions.	We have made reference to the terms used by the Organization for Economic Co-operation and Development when formulating the definition of "permanent establishment". IRD will provide more details in the DIPN to explain that the formulation would simply exclude delivery activities not involving a stock of merchandise from which an agent regularly fills orders for the company.
Technical comments on the definition of "private company" *Organization: JLCT*	
9. Under the proposed definition of "private company" (i.e. means a company incorporated in or outside Hong Kong that is not allowed to issue any invitation to the public to subscribe for any shares of debentures of the company), no company (even a listed company) is allowed to issue invitations unless it takes the further step of issuing a prospectus and getting approval from the Securities and Futures Commission. This means that even a listed (or a non-private unlisted) company is to be treated as a "private company".	If the company is incorporated in Hong Kong, then the relevant provisions in the Companies Ordinance (Cap. 622) will be applied to determine whether the company is a private company (including the examination of the company's articles to see whether it can issue any invitation to the public to subscribe for any shares or debentures of the company). If the company is incorporated outside Hong Kong, then overseas legislation, including but not limited to overseas company law, should normally be applied to determine whether the company is allowed to issue any invitation to the public to subscribe for any shares or debentures of the company . As the proposed legislation does not specify what should be looked at to determine if a private company is "not allowed"

	to issue any invitation to the public, all circumstances should be looked at to consider if there are prohibitions from its doing so. If taking additional steps and seeking approval (which does not involve a substantial change to the nature of the company) would allow the company to issue any invitation to the public, that means the company is indeed not prohibited from issuing shares. IRD will provide explanation in the DIPN if necessary.
Commencement Date *Organization: TIHK*	
10. There are different start dates for the amended section 20AC, sections 20ACA and 20AF under the Bill, which need to be rectified.	Sections 20ACA and 20AF of the Bill apply for a year of assessment commencing on or after 1 April 2015. As such, in order for an SPV to be exempt under section 20ACA, the relevant transactions must take place on or after 1 April 2015. The provision in section 20AC(5B) for the application to transactions carried out from 1 April 2015 corresponds to this date. Any transaction occurring before 1 April 2015 would be irrelevant to the new sections 20AC, 20ACA and 20AF in the Bill.

Financial Services and the Treasury Bureau
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