

**立法會**  
*Legislative Council*

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**Panel on Financial Affairs**

**Meeting on 16 March 2017**

**Background brief on open-ended fund company structure**

**Purpose**

This paper provides background information on open-ended fund company ("OFC") structure. It also gives a brief account of the views and concerns raised by Members on the benefits of introducing the OFC structure in Hong Kong and profits tax treatment of OFCs in the Fifth Legislative Council ("LegCo").

**Background**

Establishment of a legal framework for the open-ended fund company structure in Hong Kong

2. Currently, an open-ended investment fund may be established under the laws of Hong Kong in the form of a unit trust but not in corporate form due to various restrictions on capital reduction under the Companies Ordinance (Cap. 622). There are market calls for a more flexible choice of investment fund vehicle through introducing a new OFC structure in Hong Kong.<sup>1</sup> This will allow investment funds to be set up in the form of a company, but with the flexibility to create and redeem shares for investors to trade the funds, which is currently not enjoyed by conventional companies.

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<sup>1</sup> The Financial Services Development Council published two research papers on the open-ended fund company ("OFC") framework and tax issues in November 2013 and December 2015 respectively.

3. The Government conducted a public consultation on the legislative proposals for introducing the OFC structure in Hong Kong ("the OFC proposals") from March to June 2014, and introduced the Securities and Futures (Amendment) Bill 2016 ("the Bill") into LegCo in January 2016 to amend the Securities and Futures Ordinance (Cap. 571) ("SFO") to provide a legal framework for the OFC structure in Hong Kong. LegCo enacted the Securities and Futures (Amendment) Ordinance 2016 ("the Amendment Ordinance") in June 2016. The detailed operational and procedural matters of the OFC structure are to be set out in subsidiary legislation under SFO ("the OFC Rules") which are subject to negative vetting by LegCo. The Amendment Ordinance will commence operation after the OFC Rules have been put in place.

## **Major characteristics of an open-ended fund company**

### Structure and key features

4. An OFC is an open-ended collective investment scheme, which is structured in corporate form with limited liability and variable share capital. Investment in OFC (as in the case of funds generally) is typically made by way of subscription and redemption of units/shares in the fund. The OFC structure and key operators proposed under the Amendment Ordinance Bill are illustrated in **Appendix I**. An OFC has characteristics similar to a conventional limited company in that:

- (a) it will have a legal personality;
- (b) it will have a constitutive document, namely the instrument of incorporation; and
- (c) it will be governed by a board of directors who are subject to fiduciary duties and the duty to exercise reasonable care, skill and diligence, and the liability of its shareholders will be limited to the amount unpaid on their shares in the company.

5. As OFC is an investment vehicle, it –

- (a) will not be bound by restrictions on the reduction of share capital applicable to companies formed under CO, and instead will have the flexibility to vary its share capital in order to meet shareholder subscription and redemption requests;

- (b) will not be bound by restrictions on distribution out of share capital applicable to companies formed under CO and instead, may distribute out of share capital subject to solvency and disclosure requirements; and
- (c) will not be required to be licensed as a licensed corporation under SFO, but will have to be registered with the Securities and Futures Commission ("SFC"), and should delegate its investment management functions to an investment manager licensed by or registered with SFC who is appointed by the OFC board.

#### Profits tax treatment

6. Currently, profits tax exemption is given under the Inland Revenue Ordinance (Cap. 112) ("IRO") to public funds (no matter whether their central management and control is located in or outside Hong Kong) authorized by SFC. The same profits tax exemption will apply to publicly offered OFCs. At present, for privately offered funds, profits tax exemption is also provided under IRO if they are offshore funds (i.e. with their central management and control locates outside Hong Kong). So profits tax exemption will apply to offshore privately offered OFCs. Profits tax exemption is not granted to onshore privately offered OFCs (i.e. with their central management and control locates in Hong Kong) under the Bill.

#### Establishment and regulation

7. To incorporate an OFC, the applicant should apply to SFC for registration prior to applying to the Registrar of Companies ("CR") for incorporation. Besides, OFCs will be required to register under the Business Registration Ordinance (Cap. 310). OFCs seeking to offer their shares to the public must also seek the authorization of SFC under SFO.

8. SFC is the primary regulator responsible for the registration and regulation of OFCs under SFO. It is empowered by SFO to make subsidiary legislation and publish a code or guideline to regulate and provide guidance on the incorporation, management, operation, and business of OFCs. In addition, CR is responsible for the incorporation and administration of statutory corporate filings of OFCs.

## **Concerns and views expressed by Members**

9. The views and concerns expressed by Members when the Panel on Financial Affairs ("FA Panel") was briefed on the OFC proposals at the meeting on 7 April 2014, and the Bills Committee on the Securities and Futures (Amendment) Bill 2016 ("the Bills Committee") scrutinized the Bill are summarized in the ensuing paragraphs.

### Benefits of introducing the open-ended fund company structure in Hong Kong

10. Members noted that the fund industry was generally supportive of the introduction of the OFC structure in Hong Kong to provide an extra option for fund structure. The OFC structure would diversify Hong Kong's fund types, expand the fund distribution network and promote fund origination in Hong Kong to deepen and broaden Hong Kong's asset management industry. These would in turn drive demand for professional services and help strengthen Hong Kong's position as an international financial centre.

11. There was a suggestion that the Administration should consider putting in place measures to facilitate or incentivize listing and trading of OFC shares on the stock exchange. SFC pointed out that so long as the Listing Rules and other applicable requirements were met, investment funds including OFCs could be listed on the stock exchange. The Administration assured Members that it would continue to take forward initiatives to support the development of the asset management industry, including the potential establishment of the exchange distribution platform for funds in Hong Kong.

### Profits tax treatment for an open-ended fund company

12. Some Members expressed reservation about applying profits tax exemption to publicly offered OFCs due to concerns about further narrowing Hong Kong's tax base and public resources required for the operation of OFC regime. On the other hand, some Members and deputations urged the Government to extend profits tax exemption to onshore privately offered OFCs with a view to enhancing Hong Kong's competitiveness in attracting such funds to domicile in Hong Kong.

13. The Administration advised that while it recognized that tax treatment was one of the main considerations influencing the decision of fund managers on the jurisdiction where the fund was domiciled and managed and that some fund jurisdictions had offered profits tax exemption to onshore privately offered OFCs, there was concern that exempting onshore privately offered OFCs from profits tax might give rise to tax avoidance. There would be possible adverse

Base Erosion and Profits Shifting ("BEPS") implications and concern about such tax incentive being labelled as a harmful tax practice under the BEPS action plan of the Organisation for Economic Co-operation and Development.<sup>2</sup> The Government had issued a concept paper on "Proposed extension of profits tax exemption to onshore privately offered OFCs" to industry associations and professional bodies in order to gauge their preliminary views on the issue. The Government would carefully consider the views received and critically review the necessary safeguards to plug possible loopholes for abuse. If necessary, the Government would take forward amendments on profits tax exemption in a separate exercise.

### **Council question**

14. Hon Kenneth LEUNG raised a written question on "Proposed New Open-ended Fund Company Structure" at the Council meeting of 16 April 2014 which sought details of the proposed OFC structure, including comparison with similar regimes of major asset management jurisdictions, investment of OFC assets, and tax regime for OFCs. The question and the Administration's written response are hyperlinked in the **Appendix II**.

### **Latest developments**

15. On 22 February 2017, the Financial Secretary announced in the 2017-2018 Budget the Government's plan to extend the profits tax exemption to onshore privately offered OFCs, and consult the industry on the relevant legislative proposals.

16. The Government will brief FA Panel on the proposed amendments to IRO to extend profits tax exemption to onshore privately offered OFCs at the meeting to be held on 16 March 2017.

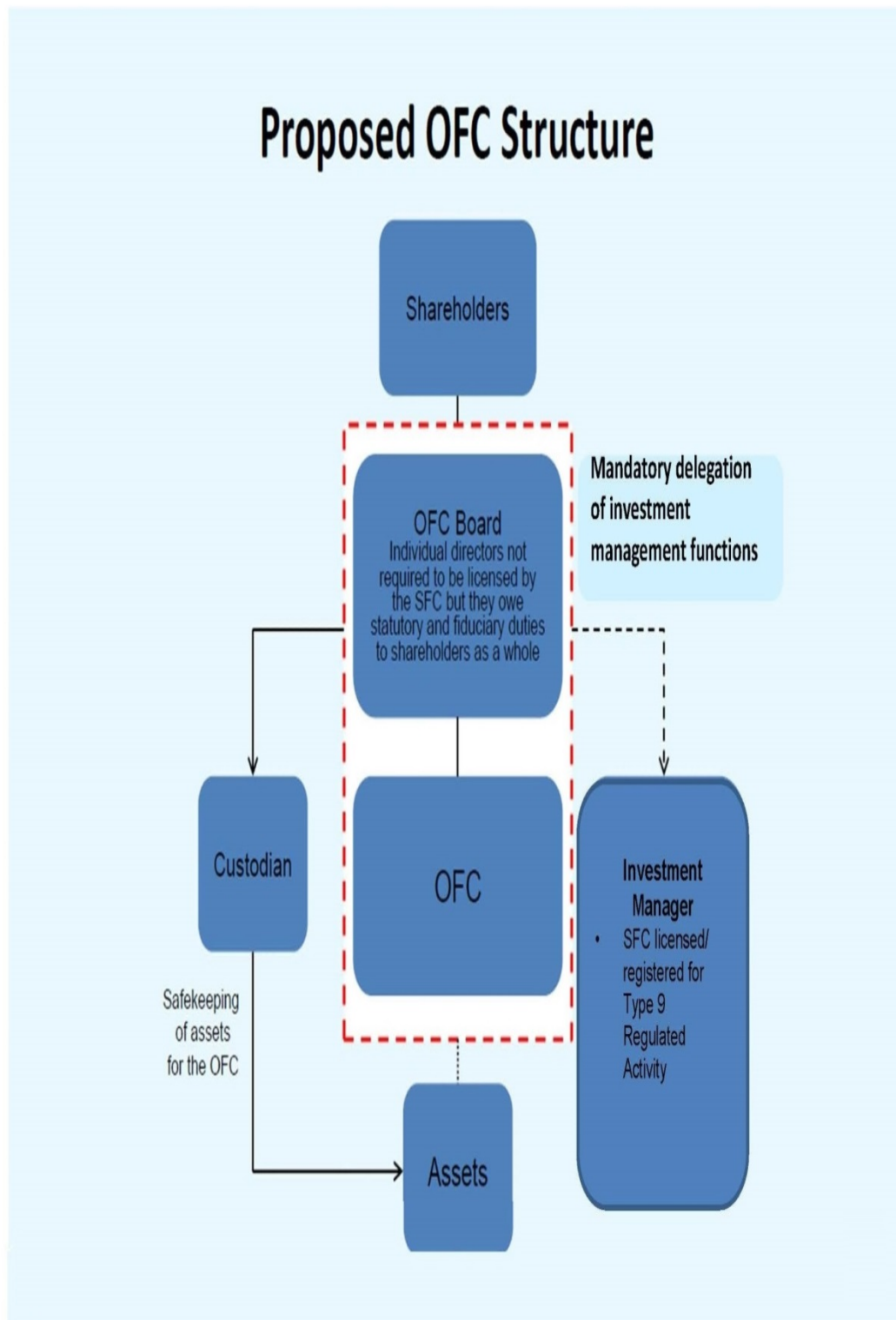
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<sup>2</sup> Base Erosion and Profits Shifting ("BEPS") refers to tax planning strategies that exploit the gaps and mismatches in tax rules (which may exist among economies) to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid. The final BEPS package released by the Organisation for Economic Co-operation and Development in October 2015 seeks to ensure multinational corporations paying a fair share of taxes, realign taxation with economic activities, and standardise international tax rules to eliminate double non-taxation.

**Relevant papers**

17. A list of relevant papers is in the **Appendix II**.

Council Business Division 1  
Legislative Council Secretariat  
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[Source: Slide 8 of the power-point presentation materials provided by the Administration for the meeting of the Bills Committee on the Securities and Futures (Amendment) Bill 2016 on 23 February 2016 (LC Paper No. CB(1)603/15-16(01)).]

## List of relevant papers

Date	Event	Paper/Minutes of meeting
18 November 2013	The Financial Services Development Council ("FSDC") released a research paper entitled "Proposals on Legal and Regulatory Framework for Open-ended Investment Companies in Hong Kong"	<a href="#">Press release</a>  <a href="#">FSDC's research paper</a> (English version only)
20 March 2014	The Administration launched a public consultation on introducing a new open-ended fund company ("OFC") structure	<a href="#">Press release</a>  <a href="#">Consultation paper</a>
7 April 2014	The Panel on Financial Affairs was briefed by the Administration and the Securities and Futures Commission on the proposals in the public consultation on introducing a new OFC structure	<a href="#">Discussion paper</a> (LC Paper No. CB(1)1180/13-14 (05))  <a href="#">Minutes</a> (LC Paper No. CB(1)1996/13-14)  <a href="#">Follow-up paper</a> (LC Paper No. CB(1)1316/13-14 (02))
16 April 2014	Hon Kenneth LEUNG raised a written question on the proposed new open-ended fund company structure	<a href="#">Hansard</a> (pages 10095 – 10098)
7 December 2015	FSDC released a paper on the tax issues on OFCs and profits tax exemption for offshore private equity funds	<a href="#">Press release</a>  <a href="#">FSDC's paper</a> (English version only)



<b>Date</b>	<b>Event</b>	<b>Paper/Minutes of meeting</b>
15 January 2016	The Administration released the consultation conclusions on OFC structure	<a href="#">Press release</a> <a href="#">Consultation conclusions</a>
2 June 2016	The Legislative Council passed the Securities and Futures (Amendment) Bill 2016	<a href="#">The Bill passed</a> <a href="#">Report of the Bills Committee</a> (LC Paper No. CB(1)896/15-16) <a href="#">Powerpoint presentation materials</a> (LC Paper No. CB(1)603/15-16 (01)) <a href="#">Legislative Council Brief</a> (Ref: SF&C/1/2/22C(2015)) <a href="#">Legal Service Division report</a> (LC Paper No. LS31/15-16)