CPA Australia
ABN 64 008 392 452
Hong Kong China Division
Rooms 1201-1206
Tai Yau Building
181 Johnston Road
Wanchai
Hong Kong
T +852 2891 3312
F +852 2832 9167
E hk@cpaaustralia.com.au
W www.cpaaustralia.com.au

By E-mail:
(mleung@legco.gov.hk)

15 September 2005

Hon James Tien Pei-chun
Chairman
Bills Committee –
Revenue (Profits Tax Exemption for Offshore Funds) Bill 2005
Legislative Council Building
8 Jackson Road
Central
HONG KONG

Revenue (Profits Tax Exemption for Offshore Funds) Bill 2005

Dear Mr Tien

On behalf of the Tax Committee of CPA Australia Hong Kong China Division, we would like to give our comments on the Revenue (Profits Tax Exemption for Offshore Funds) Bill 2005 as follows:

1) The exemption mechanism in the Bill

We note that the exemption provisions in the Bill utilise a dual "qualified transactions" and "prescribed persons" test to exempt an offshore fund from profits tax. We consider this exemption mechanism is overly prescriptive and quite narrow in scope. It starts with a limited set of transactions that might qualify for the exemption, but is silent in relation to many other transactions that an offshore fund might wish to carry out. (e.g. dealing in shares in private companies, bills of exchange, promissory notes, certificates of deposit and certain derivative contracts.) Furthermore, as new financial products are developed, these too could fall outside the scope of the exemption. The focus on "qualified transactions" also arguably excludes passive income, such as interest, from the scope of the exemption.

We are of the view that the current draft would not achieve the objective of attracting funds to Hong Kong due to the narrow scope of exemption of the Bill. Furthermore, there is a risk that offshore funds would be forced to relocate their investment managers to Singapore or another jurisdiction if the exemption were to be enacted in its current form.

2) Extending the existing widely held mutual funds exemption

One way to provide a broad based exemption for offshore funds would be to expand the exemption for bona fide widely held funds currently contained in Section 26A(1A) of the Inland Revenue Ordinance ("IRO"). For example, the exemption could be extended to cover all offshore "collective investment schemes" as defined in the Securities and Futures Ordinance which is broader than the type of funds and schemes currently covered by the exemption in Section 26A(1A) of the IRO. This broadening of the exemption would cover many funds that might want to invest in Hong Kong but which do not currently satisfy the bona fide widely held test.

3) Concerns with the deeming provisions

Irrespective of whether the current exemption mechanism in the Bill is retained, we hold some concerns in relation to the present drafting of the deeming provisions.

(a) From a tax compliance perspective, we consider that a resident investor should have at least 50% interest in the exempted offshore fund for it to have a tax reporting obligation and for it to be assessed. Without at least a 50% interest, it would be difficult for the resident investor to ascertain information for tax reporting purposes and to determine if the relevant gains are capital in nature and / or offshore in nature and thus not assessable. In addition, further elaborations or guidance on how the triggering threshold should be calculated are required as offshore funds may have issued different classes of shares.

(b) Another concern we have with the drafting of the deeming provisions is that it will create tax liabilities on individuals who traded in Hong Kong securities. Practically, these individuals would not otherwise be subject to profits tax if they had traded in the securities in their own names in the past. Thus, if the Bill is enacted, it would impose tax liabilities that did not exist before.

(c) There is also a concern that a resident investor may be subject to double taxation under the deeming provisions if the non-resident funds would have to pay tax on the whole of its profits in their home jurisdictions, e.g. the US.

4) Profits are attributed under the deeming provisions but losses are not

The Bill currently attributes exempt profits of an offshore fund to certain resident investors. However, if the fund instead makes a loss, the loss is not attributed to the resident investor. This inconsistent treatment can lead to inequitable results. This would mean that the investor would be subject to tax on an investment that economically generated a loss.

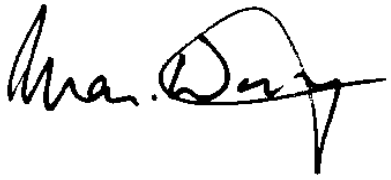
We recommend that amendments be made so that the deeming provisions would attribute losses as well as profits to the resident investor and relevant provisions be inserted to allow the resident investor to set off and carry forward any such losses.

5) Definition of “associate” too complicated

We consider the definition of “associate” contained in the proposed Section 20AE(10) is too complicated and should be simplified.

Should you require further details or have any questions, please contact Ms Karen Yeung, Media Officer of CPA Australia Hong Kong China Division on 2202 2722 or fax to 2832 9167 or email to karen.yeung@cpaaustralia.com.au.

Yours sincerely



MARCELLUS WONG FCPA (AUST.)
TAX COMMITTEE CHAIRMAN
CPA AUSTRALIA
HONG KONG CHINA DIVISION