

立法會
Legislative Council

LC Paper No. CB(1)1297/14-15
(These minutes have been seen
by the Administration)

Ref : CB1/BC/5/14

Bills Committee on Inland Revenue (Amendment) Bill 2015

**Minutes of first meeting held on
Tuesday, 28 April 2015, at 8:30 am
in Conference Room 2B of the Legislative Council Complex**

Members present : Hon Christopher CHEUNG Wah-fung, SBS, JP (Chairman)
Hon CHAN Kam-lam, SBS, 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

Member absent : Hon Abraham SHEK Lai-him, GBS, JP

**Public Officers
attending** : Agenda item II

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

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 Election of Chairman

Mr CHAN Kam-lam, the member with the highest precedence in the Council among all members of the Bills Committee present, presided over the election of Chairman of the Bills Committee. He invited nominations for the chairmanship of the Bills Committee.

2. Ir Dr LO Wai-kwok nominated Mr Christopher CHEUNG and the nomination was seconded by Mr Andrew LEUNG. Mr Christopher CHEUNG accepted the nomination. There being no other nomination, Mr Christopher CHEUNG was elected Chairman of the Bills Committee. Members agreed that there was no need to elect a Deputy Chairman.

II Meeting with the Administration

- (LC Paper No CB(3)542/14-15 —The Bill
File Ref: ASST/3/1/5C(2014) —Legislative Council Brief issued by the Financial Services and the Treasury Bureau
- LC Paper No. LS56/14-15 —Legal Service Division Report
LC Paper No. CB(1)770/14-15(01) —Marked-up copy of the Bill prepared by the Legal Service Division (Restricted to members)
- LC Paper No. CB(1)770/14-15(02) —Paper on Inland Revenue (Amendment) Bill 2015 prepared by the Legislative Council Secretariat (background brief)
- LC Paper No. CB(1)770/14-15(03) —Letter dated 10 April 2015 from Legal Service Division to the Administration
- LC Paper No. CB(1)770/14-15(04) —Administration's response to Legal Service Division's letter dated 10 April 2015)

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

Follow-up actions

4. The Administration was requested to provide written information on the following –

- (a) the operation of offshore private equity funds and taxation regime in relation to the profits derived from transactions in securities of offshore private companies by offshore funds under the existing arrangement;
- (b) cases, if any, in which profits derived from transactions in securities of overseas private companies by offshore funds had been taxed in Hong Kong since 2006;
- (c) breakdown of investment in portfolio companies by private equity companies in Hong Kong, such as the ratio of local and overseas portfolio companies they had invested in, and proportion of their respective investment in public and private companies by way of

securities in these companies or otherwise to shed light on the concern whether the proposed profits tax exemption would benefit offshore portfolio companies at the expense of local companies;

- (d) financial and economic implications to Hong Kong (i.e. cost and benefits, whether actual or anticipated) of the proposed profits tax exemption for offshore private equity funds;
- (e) similar measures in Singapore in respect of profits tax exemption for offshore private equity funds; and
- (f) the private equity fund industry of Hong Kong's competitors in the region, such as sizes of capital under management by such funds in these countries and the respective percentages in Asia.

(Post meeting note: The Administration's response was issued to members vide LC Paper No. CB(1)849/14-15(02) on 15 May 2015.)

Invitation of views

5. Members agreed to invite views on the Bill from interested parties and members of the public.

III Any other business

6. There being no other business, the meeting ended at 10:23 am.

Council Business Division 1
Legislative Council Secretariat
8 October 2015

**Proceedings of first meeting of the
Bills Committee on Inland Revenue (Amendment) Bill 2015
on Tuesday, 28 April 2015, at 8:30 am
in Conference Room 2B of the Legislative Council Complex**

Time marker	Speaker	Subject(s)	Action required
Election of Chairman			
000107 – 000232	Mr CHAN Kam-lam Ir Dr LO Wai-kwok Mr Andrew LEUNG Mr Christopher CHEUNG	Election of Chairman Mr Christopher CHEUNG was elected Chairman of the Bills Committee.	
Meeting with the Administration			
000323 – 001247	Chairman Administration	Briefing on the key elements of the Inland Revenue (Amendment) Bill 2015 ("the Bill") by the Administration (LC Paper No. CB(1)800/14-15(01)).	
001248 – 002620	Chairman Mr Charles MOK Administration	<p>Mr Charles MOK enquired whether investments in local start-ups by venture capital funds would be eligible for the proposed profits tax exemption.</p> <p>The Administration's response –</p> <p>(a) the investments in start-ups by venture capital funds would be eligible for the proposed profits tax exemption if the qualifying conditions set out in the Bill in respect of the portfolio company, specified transaction, qualifying fund, and the use of special purpose vehicles, etc. were met; and</p> <p>(b) in particular, the portfolio company should be a private company incorporated outside Hong Kong.</p> <p>Mr Charles MOK raised the following concern and enquiry about the proposed profits tax exemption –</p> <p>(a) it did not appear to be able to attract more private equity funds to invest in local start-ups and in particular, promote the development of technology start-ups in Hong Kong; and</p>	

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		<p>(b) whether it would in effect benefit offshore portfolio companies at the expense of local companies.</p> <p>Mr MOK sought information about the breakdown of investment in portfolio companies by private equity companies in Hong Kong, such as the ratio of local and overseas portfolio companies they had invested in, and proportion of their respective investment in public and private companies by way of securities in these companies.</p> <p>The Administration's response –</p> <p>(a) extending profits tax exemption to transactions in securities in private companies incorporated in Hong Kong, as Mr MOK suggested, would involve much broader and in-depth considerations. During the consultation with the fund industry, the industry had expressed appreciation of the issues involved and welcomed the current proposal as a first step of a more far-reaching change, if considered desirable in future; and</p> <p>(b) the current proposal on profits tax exemption would help attract more offshore private equity fund managers 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. This would help strengthen Hong Kong's position as an international asset management centre and foster the further development of the financial services sector as a whole.</p>	<p>The Administration to follow up as per paragraph 4(c) of the minutes.</p>
002621 – 003559	Chairman Mr Kenneth LEUNG Administration	<p>Mr Kenneth LEUNG sought clarification on the following –</p> <p>(a) the definitions of offshore fund, specified person and specified transaction in the Bill;</p> <p>(b) whether the dividend income received by an offshore fund from the portfolio company would be subject to profits tax; and</p>	

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		<p>(c) the handling of a transaction in securities in a local company by an offshore private equity fund in future, as it would not be exempted from profits tax under the Bill.</p> <p>The Administration's response –</p> <p>(a) the Bill proposed to amend the definition of "securities" such that a transaction in securities in an eligible private company (i.e. portfolio company) would not be excluded from a "specified transaction";</p> <p>(b) the Bill did not amend the definitions of "non-resident person" and "specified person" in the Inland Revenue Ordinance (Cap. 112) ("IRO");</p> <p>(c) one of the definitions of "specified person" in the IRO referred to a corporation licensed or an authorized financial institution registered under the Securities and Futures Ordinance (Cap. 571) ("SFO") for carrying on a business in any regulated activity within the meaning of the SFO. There was no need to amend the IRO separately even if there was any change in the definitions of the relevant licensed corporation or authorized financial institution in the SFO;</p> <p>(d) generally speaking, dividends on securities acquired through the specified transactions by an offshore fund were exempt from profits tax, provided that the dividend payments were not used as a disguise for service fees paid to the fund manager. Each case would be determined on its own merits, taking reference from the general standard adopted by the asset management industry in relation to service fees charged. For example, a typical fee structure was one in which the fund manager charged a flat 2% of total asset value as a management fee per year and an additional 20% of any profits earned; and</p> <p>(e) the Bill provided clear tax exemption to transactions conducted by offshore private equity funds in respect of eligible overseas</p>	

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		<p>portfolio companies. For transactions in respect of local companies, the existing principle of taxation would apply. Generally speaking, only profits derived from Hong Kong from trade, profession or business were subject to profits tax, while profits arising from the sale of capital assets would not be taxed.</p>	
003600 – 004440	Chairman Ir Dr LO Wai-kwok Administration	<p>Ir Dr LO Wai-kwok sought information on the following –</p> <ul style="list-style-type: none"> (a) the estimated number of private equity funds to be attracted to operate in Hong Kong, and the estimated growth in the total capital under management in private equity funds in Hong Kong, etc. after the implementation of the proposed profits tax exemption for offshore private equity funds; (b) whether Hong Kong's competitors in the region offered any tax exemption to private equity funds; and (c) the development of private equity funds in the Mainland, and how Hong Kong could leverage on such development in the Mainland. <p>The Administration's response –</p> <ul style="list-style-type: none"> (a) since the introduction of profits tax exemption for offshore funds in 2006, the combined fund management business in Hong Kong had grown from HK\$6,154 billion to HK\$16,007 billion as at the end of 2013; (b) while it would be difficult to quantify the benefits of the proposed profits tax exemption for offshore private equity funds, the proposal was expected to attract more offshore private equity fund managers to set up and expand their business in Hong Kong, hire local asset management, investment and advisory services which would be conducive to further development of Hong Kong's asset management industry; 	

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		<p>(c) there were similar measures in Hong Kong's competitors (e.g. Singapore) in the region providing tax exemption to transactions conducted by offshore private equity funds in respect of eligible overseas portfolio companies; and</p> <p>(d) the private equity fund industry in the Mainland had been growing rapidly. There was keen interest from the Mainland market players in raising private equity funds in Hong Kong for making investment in the Mainland, or using Hong Kong as a base for managing assets. In addition, the Hong Kong stock market provided a good option for the private equity companies when they planned for raising capital, e.g. by listing in Hong Kong.</p>	
004441 – 005142	Chairman Mr SIN Chung-kai Administration	<p>Mr SIN Chung-kai made the following enquiry and views –</p> <p>(a) what the existing policy was in respect of the regulation of operation of private equity funds in Hong Kong; and</p> <p>(b) the Administration should consider setting up a registration system for offshore private equity funds for tax exemption purposes.</p> <p>The Administration's response –</p> <p>(a) private equity fund managers would be subject to the regulation of the Securities and Futures Commission if they conducted transactions regulated under the SFO, such as transactions in securities of listed companies, futures contracts, etc., whereas transactions in securities of private companies or other investments not covered by the SFO were not subject to Securities and Futures Commission's regulation;</p> <p>(b) the transaction in securities of a private company would be eligible for the proposed profits tax exemption if the qualifying conditions set out in the Bill in respect of the portfolio company, specified transaction, qualifying fund, and the use of special</p>	

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		<p>purpose vehicles, etc. were met; and</p> <p>(c) the Administration took note of, and would explore with the fund industry as appropriate, Mr SIN Chung-kai's suggestion on a registration system for private equity funds.</p>	
005143 – 010001	Chairman Mr Kenneth LEUNG Administration	<p>Mr Kenneth LEUNG made the following suggestions –</p> <p>(a) the Bills Committee should invite public views on the Bill; and</p> <p>(b) the Administration should consider relaxing or waiving the qualifying conditions for the proposed profits tax exemption in respect of certain types of local portfolio companies (e.g. companies and start-ups related to the environmental, clean energy or high-technology businesses).</p> <p>The Administration responded that extending profits tax exemption to transactions in securities in private companies incorporated in Hong Kong required much broader policy considerations which would take time as it would involve such issues as justifications for determining the target types of companies and the relevant approval procedures, etc.</p> <p>Mr Kenneth LEUNG sought clarification on the following –</p> <p>(a) the taxation on dividends received by an offshore fund;</p> <p>(b) whether the Inland Revenue Department ("IRD") would consider applications from private equity fund managers for Advance Pricing Arrangement in respect of their service fees charged, so as to provide greater certainty on the tax liability for the fund managers; and</p> <p>(c) whether IRD anticipated any need for additional manpower in view of its increasing workload.</p>	

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		<p>The Administration's response –</p> <ul style="list-style-type: none"> (a) generally speaking, dividends on securities acquired through the specified transactions by an offshore fund were exempt from profits tax, provided that the dividend payments were not used as a disguise for service fees paid to the fund manager; (b) when evaluating whether the fees charged by a fund manager was reasonable, IRD would determine each case on its own merits, making reference to the general standard adopted by the asset management industry in relation to service fees charged; (c) when appropriate, the IRD would consider accepting applications from private equity fund managers for Advance Pricing Arrangement in respect of their service fees charged; and (d) the IRD would review its manpower situation as appropriate and seek additional manpower when necessary. 	
010002 – 010200	Chairman Administration	<p>In response to the Chairman's enquiry about the qualifying conditions for portfolio company in relation to the holding of immovable property in Hong Kong, the Administration advised that –</p> <ul style="list-style-type: none"> (a) under the proposal, it would adopt a threshold that at all times within the three years before a transaction in securities in the portfolio company, the value of the immovable property could not exceed 10% of the value of the total assets of the private company; (b) the qualifying conditions in question would serve as safe harbour within which the portfolio companies concerned could be accepted as having met the objective of the proposed policy; and (c) the threshold of 10% reflected the views gathered from the fund industry during consultation. 	

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010201 – 011417	Chairman Miss CHAN Yuen-han Administration	<p>Miss CHAN Yuen-han sought elaboration on the justification for the proposed extension of the profits tax exemption for offshore funds to private equity funds, and expressed concern about the possibility of the proposal being abused and giving rise to tax avoidance.</p> <p>The Administration's response –</p> <ul style="list-style-type: none"> (a) given the economic growth in Asia in recent years, Hong Kong was in an advantageous position to attract more funds of various types, in particular private equity funds, to operate in Hong Kong, thereby broadening the variety and scope of Hong Kong's fund business; (b) the proposed extension of the profits tax exemption would allow offshore private equity funds to enjoy the same exemption under the IRO as those currently available to other offshore funds; (c) taking into account similar measures/proposals by other competitors in the region, the Administration considered it both necessary and beneficial to strengthen the measures in Hong Kong with a view to expanding the fund market and enhancing competitiveness amidst regional competition; and (d) under the proposal, qualifying conditions on the portfolio companies and qualifying funds were imposed to ensure that only bona fide offshore private equity funds would be eligible for the proposed tax exemption. 	
011418 – 011710	Chairman Administration	<p>The Chairman enquired about the proposal's cost, in the form of tax revenue lost, and its benefits to the financial services industry in Hong Kong.</p> <p>The Administration's response –</p> <ul style="list-style-type: none"> (a) the actual cost of the proposal in the form of tax revenue forgone should not be significant; and 	

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		<p>(b) the proposal would help attract more offshore private equity fund managers 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. This would help strengthen Hong Kong's position as an international asset management centre and foster the further development of Hong Kong's financial services sector as a whole.</p>	
<p>011711 – 013609</p>	<p>Chairman Mr Alan LEONG Administration</p>	<p>Mr Alan LEONG sought elaboration on the following –</p> <p>(a) the operation of offshore private equity funds and taxation regime in relation to the profits derived from transactions in securities of offshore private companies by offshore funds under the existing arrangement;</p> <p>(b) the financial and economic implications to Hong Kong (i.e. cost and benefits, whether actual or anticipated, in particular, whether the Administration was codifying an existing practice that would result in no tax loss) of the proposed profits tax exemption for offshore private equity funds; and</p> <p>(c) whether tax exemption was the sole factor in attracting offshore private equity fund managers to set up business in Hong Kong.</p> <p>The Administration's response –</p> <p>(a) apart from taxation, factors affecting offshore private equity fund managers' decisions to operate in Hong Kong included the liquidity and regulation of the financial market, the connection with other markets, the supply of professional services, etc.;</p> <p>(b) there were calls from the fund industry for providing clear tax exemption to transactions conducted by offshore private equity funds in respect of eligible overseas portfolio companies. Taking into account similar measures/proposals by other</p>	<p>The Administration to follow up as per paragraphs 4(a) and 4(d) of the minutes.</p>

Time marker	Speaker	Subject(s)	Action required
		<p>competitors in the region, the Financial Services Development Council had also made relevant recommendations regarding tax exemptions for private equity funds; and</p> <p>(c) the Administration was committed to creating a favourable investment environment to promote the development of Hong Kong's fund and asset management business.</p>	
013610 – 014123	Chairman Mr NG Leung-sing Administration	<p>Mr NG Leung-sing expressed support for the proposed profits tax exemption for private equity funds, and called for its early implementation for the following reasons –</p> <p>(a) the actual tax revenue forgone as a result of the proposal should be insignificant, and the proposal would help attract more offshore private equity fund managers 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; and</p> <p>(b) the proposed exemption could help expand Hong Kong's fund market and enhance its competitiveness amidst regional competition.</p> <p>Mr NG requested the Administration to provide information on similar measures in Singapore in respect of profits tax exemption for offshore equity funds for members' reference.</p>	The Administration to follow up as per paragraph 4(e) of the minutes.
014124 – 014425	Chairman Mr Kenneth LEUNG Administration	<p>Mr Kenneth LEUNG make the following enquiries –</p> <p>(a) whether there had been cases in which profits derived from transactions in the securities of overseas private companies by offshore funds had been taxed in Hong Kong since 2006; and</p>	The Administration to follow up as per paragraph 4(b) of the minutes.

Time marker	Speaker	Subject(s)	Action required
		<p>(b) whether transactions in bonds issued by an overseas private company conducted by offshore private equity funds would be qualified for the proposed profits tax exemption.</p> <p>Regarding (b) above, the Administration advised that the Bill amended the definition of "securities" such that a transaction in securities (including shares, stocks, bonds, etc.) in an eligible private company would be classified as a "specified transaction", and would therefore qualify for the proposed profits tax exemption.</p>	
014426 – 014902	Chairman Ir Dr LO Wai-kwok Administration	<p>Ir Dr LO Wai-kwok sought information on the following –</p> <p>(a) the source of the figure of US\$114.6 billion of total capital under management in private equity funds in Hong Kong in end 2014; and</p> <p>(b) the private equity funds industry of Hong Kong's competitors in the region, such as sizes of capital under management by such funds in these countries and the respective percentages in Asia.</p> <p>The Administration advised that the figure in (a) above was obtained from a journal of the private equity fund industry.</p>	The Administration to follow up as per paragraph 4(f) of the minutes.
014903 – 015054	Chairman	<p>The Chairman expressed support for the proposed profits tax exemption for private equity funds for the following reasons –</p> <p>(a) the proposal would help attract more offshore private equity fund managers 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. This would in turn help strengthen Hong Kong's position as an international asset management centre and foster the further development of Hong Kong financial services sector as a whole; and</p>	

Time marker	Speaker	Subject(s)	Action required
		<p>(b) the proposal could help enhance Hong Kong's competitiveness amidst regional competition in expanding the fund market.</p> <p>The Chairman called on the Administration to step up the promotion and publicity about the benefits of the proposed profits tax exemption to the financial services industry and other relevant professional services in Hong Kong.</p>	
015055 – 015330	Chairman Miss CHAN Yuen-han Ir Dr LO Wai-kwok Mr Kenneth LEUNG	Invitation of views Meeting arrangements	