

## **Bills Committee on Inland Revenue (Amendment) Bill 2015**

### **Government's Responses to the Follow-up Actions Arising from the Discussion at the Meeting on 28 April 2015**

This paper sets out the Government's responses to the issues raised by Members in relation to the Inland Revenue (Amendment) Bill 2015 ("the Bill") at the meeting of 28 April 2015.

- (a) The current profits tax exemption regime for offshore funds does not cover transactions in securities of private companies. As pointed out by the Financial Services Development Council in its Research Paper No. 6 published in November 2013, "this has resulted in private equity (PE) funds taking onerous procedures to mitigate their potential exposure to Hong Kong profits tax. This has put Hong Kong in a relatively disadvantaged position for attracting PE funds to Hong Kong."

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 provide the private equity fund industry with the tax certainty that the profits derived from transactions in securities of private companies outside Hong Kong will not be subject to tax liability in Hong Kong, so as to attract more private equity fund managers to set up or expand their business in Hong Kong and hire local asset management, investment and advisory services. Income received by local fund managers and other service providers will continue to be subject to Hong Kong tax.

- (b) Per records of the Inland Revenue Department, since the inception of offshore fund tax exemption regime in 2006, no profits tax assessment has been raised to assess profits derived by private equity funds from the disposal of private companies outside Hong Kong.
- (c) & (f) In terms of the size of capital under management by private equity funds, Hong Kong ranked second, after Mainland China, in Asia, accounting for 21% of the total capital under management as at end 2014. Please see table below for information about the total capital under management of private equity funds in selected economies in Asia.

Total capital under management of private equity funds  
(US\$ Million)

| Ranking | Economies in Asia <sup>1</sup> | End 2013       | End 2014       | % in Asia (for 2014) |
|---------|--------------------------------|----------------|----------------|----------------------|
|         | <b>Asia</b>                    | <b>490,588</b> | <b>549,589</b> | <b>100</b>           |
| 1       | Mainland China                 | 196,306        | 224,483        | 40.8                 |
| 2       | Hong Kong <sup>2</sup>         | 95,521         | 114,569        | 20.8                 |
| 3       | Japan                          | 56,298         | 61,175         | 11.1                 |
| 4       | India                          | 47,541         | 50,531         | 9.2                  |
| 5       | South Korea                    | 41,749         | 46,799         | 9                    |
| 6       | Singapore                      | 24,732         | 25,958         | 4.7                  |
| 7       | Malaysia                       | 7,909          | 8,393          | 1.5                  |
| 8       | Taiwan                         | 7,070          | 7,120          | 1.3                  |
| 9       | Vietnam                        | 4,387          | 4,387          | 0.8                  |
| 10      | Indonesia                      | 2,999          | 3,074          | 0.6                  |

*Source: Asia Venture Capital Journal*

There could be a host of different factors that affect a fund manager's decision in making private equity investments, with the expected after-tax profitability of an investment being a major factor. According to the available information, in respect of the total private equity investments in the Asia Pacific Region made by private equity firms worldwide, the proportion of investments in portfolio companies in Hong Kong (in terms of the deal amount) is 2.57%, 1.88% and 9.77% in 2012, 2013 and 2014 respectively.<sup>3</sup>

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

<sup>1</sup> Excluding Australia, New Zealand and Papua New Guinea.

<sup>2</sup> We do not have readily available data on the breakdown of investment in portfolio companies by private equity companies in Hong Kong.

<sup>3</sup> Source: Asian Venture Capital Journal

structure. This will have implications on Governments' tax revenue.

- (d) In lieu of legal certainty, offshore private equity funds normally use the asset management and professional services in other jurisdictions so as to minimize their exposure to Hong Kong tax liability, and as mentioned above, since the inception of offshore fund tax exemption regime in 2006, no profits tax assessment has been raised to assess profits derived by private equity funds from the disposal of private companies outside Hong Kong. Hence, we expect that the cost of the proposal to Hong Kong should be minimal.

On the other hand, the proposal will 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 foster the further development of our financial services sector and drive demand for other relevant professional services, such as business consulting, tax, accounting and legal services. Whilst the actual benefits may not be quantifiable at this stage, it can be of reference that since the implementation of the profits tax exemption for offshore funds in 2006, Hong Kong's combined fund management business has grown by 2.6 times from \$6,154 billion as at the end of 2006 to \$16,007 billion as at the end of 2013.

- (e) Singapore has introduced an offshore fund exemption scheme which gives offshore funds exemption from tax on income from designated investments including most types of investment like stocks and shares of any company, other than an unlisted company that is in the business of trading or holding immovable property locally. The proposed extension of the profits tax exemption for offshore funds to private equity funds is comparable.

**Financial Services Branch**  
**Financial Services and the Treasury Bureau**  
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