

立法會
Legislative Council

LC Paper No. LS56/14-15

**Paper for the House Committee Meeting
on 10 April 2015**

**Legal Service Division Report on
Inland Revenue (Amendment) Bill 2015**

I. SUMMARY

- 1. The Bill** The Bill seeks to amend the Inland Revenue Ordinance (Cap. 112) to:
- (a) extend the profits tax exemption for non-resident persons to include transactions in securities of, or issued by, certain private companies incorporated outside Hong Kong;
 - (b) exempt non-resident persons that are qualifying funds from profits tax;
 - (c) exempt special purpose vehicles from the payment of profits tax; and
 - (d) provide for related matters.
- 2. Public Consultation** According to the LegCo Brief, the Administration has consulted the industry on the legislative proposal to extend the profits tax exemption for offshore funds to private equity funds. The industry generally welcomes the proposal and urges for its early implementation.
- 3. Consultation with LegCo Panel** The Panel on Financial Affairs was consulted on 5 January 2015 and members had no objection to the Administration introducing the legislative proposal into the Legislative Council.
- 4. Conclusion** The scrutiny of the Bill is continuing and a further report will be made, if necessary. Members may wish to consider whether a Bills Committee should be formed to study the Bill in detail.

II. REPORT

The date of First Reading of the Bill is 25 March 2015. Members may refer to the LegCo Brief (File Ref.: ASST/3/1/5C(2014)) issued by the Financial Services and the Treasury Bureau on 18 March 2015 for further details.

Object of the Bill

2. The Bill seeks to amend the Inland Revenue Ordinance (Cap. 112) to extend the profits tax exemption for non-resident persons to include transactions in securities of, or issued by, certain private companies incorporated outside Hong Kong; to exempt non-resident persons that are qualifying funds from profits tax; to exempt special purpose vehicles from the payment of profits tax; and to provide for related matters.

Background

3. Cap. 112 was amended in 2006 to exempt offshore funds from profits tax. Under section 20AC of Cap. 112, non-resident entities (which can be individuals, partnerships, trustees of trust estates or corporations) are exempt from tax for profits derived from "specified transactions" carried out in Hong Kong which cover transactions in securities, future contracts, foreign exchange contracts, foreign currencies, exchange-traded commodities and transactions consisting in the making of a deposit other than by way of a money-lending business. To qualify for the exemption, the transactions must be carried out by "specified persons", which include corporations and authorized financial institutions licensed or registered under Part V of the Securities and Futures Ordinance (Cap. 571). Transactions that are incidental to carrying out the "specified transactions" are also exempted from profits tax.

4. The current definition of "securities" as one of the "specified transactions" in Schedule 16 to Cap. 112 does not include shares, debentures and the related rights, options or interests of a private company. In consequence, any transaction in the securities of a private company from which the offshore fund made profits could be subject to profits tax in Hong Kong. Also, offshore private equity funds will not qualify for the profits tax exemption if they are not managed by corporations or authorized financial institutions licensed or registered by the Securities and Futures Commission under Cap. 571.

5. According to paragraphs 3 and 22 of the LegCo Brief, by providing a clear tax exemption to transactions conducted by offshore private equity funds in respect of eligible overseas portfolio companies, the Administration hopes to 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 and other relevant professional services.

Provisions of the Bill

6. The main purpose of the Bill is to amend Cap. 112 to give effect to the above proposal. The major proposed amendments are summarized below.

Extension of profits tax exemption to include transactions in securities of offshore private companies

7. The Bill seeks to amend the definition of securities under Schedule 16 to Cap. 112 (clause 11(4)) so that transactions in securities in eligible offshore private companies would be exempted from profits tax under section 20AC. To qualify for the exemption, a company has to meet the following conditions as set out in the proposed definition of "excepted private company" under the new section 20ACA(2) (as added by clause 5):

- (a) it is a private company incorporated outside Hong Kong; and
- (b) at all times within the 3 years before a transaction in securities in the private company is carried out, it did not:
 - (i) carry on any business through or from a permanent establishment in Hong Kong;
 - (ii) hold share capital in one or more private companies carrying on any business through or from a permanent establishment in Hong Kong, where the aggregate value of the capital exceeded 10% of the value of its own assets; and
 - (iii) hold immovable property in Hong Kong or share capital in one or more private companies with direct or indirect holding of immovable property in Hong Kong, where the aggregate value of the holding of the property and capital exceeded 10% of the value of its own assets.

Exemption of non-resident persons that are qualifying funds from profits tax

8. Clause 4 of the Bill seeks to amend section 20AC(2) of Cap. 112 to exempt a non-resident person that is a qualifying fund from profits tax in respect of assessable profits of the person arising from "specified transactions". This is to relax the requirement for the "specified transactions" to be arranged by "specified persons" by exempting "specified transactions" of an offshore fund which is a qualifying fund from profits tax even if these transactions are not carried out through a "specified person". In order to be a "qualifying fund" as defined in the proposed section 20AC(6), a fund has to satisfy the following conditions:

- (a) at all times after the final closing of sale of interests (i) the number of investors exceeds 4; and (ii) the capital commitments made by investors exceed 90% of the aggregate capital commitments; and
- (b) there is an agreement governing the operation of the fund that the originator and its associates will not receive more than 30% of the net proceeds arising out of the transactions of the fund (after deducting the portion attributable to their capital contributions to the fund).

9. According to the Administration, to prevent abuse or round-tripping by onshore private equity funds and other resident entities disguised as offshore funds to take advantage of the proposed exemption, the existing deeming provision¹ will equally apply to offshore private equity funds and qualifying funds.

Extension of profits tax exemption to special purpose vehicles (SPVs)

10. The Bill seeks to amend the definition of securities under Schedule 16 to Cap. 112 so that transactions in securities in SPVs would be exempted from profits tax under section 20AC. A SPV as defined by the new section 20ACA(2) is a corporation, partnership, trustee of a trust estate or any other entity that meets the following conditions before it is qualified for the tax exemption:

- (a) it is wholly or partially owned by a non-resident person;

¹ Under section 20AE of Cap. 112, a resident person (alone or jointly with his associates) holding a beneficial interest of 30% or more in a non-resident person, the assessable profits of such non-resident person from specified transactions and incidental transactions carried out in Hong Kong are to be regarded as the assessable profits of the resident person.

- (b) it is established solely for the purpose of holding and administering one or more eligible offshore private companies;
- (c) it is incorporated, registered or appointed in or outside Hong Kong;
- (d) it does not carry on any trade or activities except for the purpose of holding and administering one or more eligible offshore private companies; and
- (e) it is not itself an eligible offshore private company.

11. Apart from proposed exemption of tax for profits derived from transactions in securities in SPVs under section 20AC, clause 5 adds a new section 20ACA to Cap. 112 to exempt a SPV, which may be a resident person or a non-resident person, from the payment of tax in respect of assessable profits arising from certain transactions concerning an interposed SPV (i.e. a SPV that has an indirect beneficial interest in an eligible offshore private company through one or more interposed persons that is/are SPVs), or an eligible offshore private company.

12. Clause 6 amends section 20AD of Cap. 112 to extend the scope of that section to provide that loss from transactions referred to in the new section 20ACA(1) sustained by a SPV, as with other non-resident persons, are not available for set off against any of its assessable profits for any subsequent year of assessment.

13. Clause 8 adds a new section 20AF to Cap. 112 to provide that in certain circumstances, the assessable profits of a SPV that is held by a non-resident person and exempt from the payment of tax under the new section 20ACA are to be regarded as the assessable profits of a resident person. A new Schedule 15A is proposed to be added to Cap. 112 under clause 10 to contain a formula for ascertaining the amount to be regarded as the assessable profits of a resident person under the new section 20AF.

Other amendments

14. The Bill also makes related and other textual amendments.

Commencement

15. The Bill, if passed, would come into operation on the day on which it is published in the Gazette.

Public Consultation

16. According to paragraph 23 of the LegCo Brief, the Administration has consulted the industry on the legislative proposal to extend the profits tax exemption for offshore funds to private equity funds. The industry generally welcomes the proposal and urges for its early implementation.

Consultation with LegCo Panel

17. The Clerk to the Panel on Financial Affairs (the Panel) has advised that the Panel was consulted on the proposal on 5 January 2015. While the Panel had no objection to the proposal, some members made enquiries on various issues, including the qualifying conditions for offshore private equity funds and desirability of relaxing the conditions for certain types of private companies like high-technology companies, benefits of the proposal to investors and the financial services industry, and assessment of revenue forgone.

Conclusion

18. The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. In view of the issues raised by members at the above Panel meeting, Members may wish to consider whether to set up a Bills Committee to study the Bill in detail.

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