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羅兵咸永道

Clerk to Bills Committee on Inland Revenue (Amendment) (No. 4) Bill 2017
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Attention: Mr Kenneth Leung

31 August 2017

Submission on the Inland Revenue (Amendment) (No. 4) Bill 2017

Dear Sir,

We thank you for the opportunity to provide our comments on the Inland Revenue (Amendment) (No. 4) Bill 2017 (the Bill), which seeks to amend the Inland Revenue Ordinance (IRO) to provide a profits tax exemption to private open-ended fund companies (OFC) with their central management and control exercised in Hong Kong.

We reiterate our full support the intention behind the introduction of the OFC regime and the Bill, and again, stress the importance of having an attractive regime for it to be successful. We believe that some aspects of the Bill should be clarified or changed in order to make the tax regime competitive and have made several submissions to the Financial Services and the Treasury Bureau since its first consultation paper was issued in April 2014 to date[1]. Although we hope our comments were considered, only a few of our concerns were addressed and the Bill remains substantially the same as the draft proposals.

1. It should be in Hong Kong's interest to ensure that the OFC regime is competitive with other comparable jurisdictions. We note that in order jurisdictions where a similar regime exists (e.g. Luxembourg), there are no restrictions on the minimum number of investors nor level of participation interest for the income tax exemption to apply.

   In addition, the OFC regime should be as attractive as the existing offshore fund tax exemption regime in Hong Kong[2], which is applicable to Cayman Islands and other offshore funds with fund managers in Hong Kong.

   We believe that the conditions an OFC needs to meet for the tax exemption should be practical and kept to a minimum. With this in mind, we are pleased to see that the Bill has relaxed the requirement such that the definition of "non-closely held" now only requires at least 4 investors (where there is a qualified investor), or at least 10 investors (where there is no qualified investor), that needs to invest more than HK$20 million. However, we also have the following comments:

   a. The minimum investment requirement for a "normal" investor of HK$20 million (US$2.58 million) is significantly higher than the normal minimum investment requirement for typical Cayman Islands funds currently in the market of US$100,000. This minimum investment requirement should be revisited.

1 Submissions were made by PwC to the FSTB on 19 June 2014, 27 November 2015, 19 April 2016, and 29 March 2017.
2 Under the Revenue (Profits Tax Exemption for Offshore Funds) Ordinance 2006 and the Inland Revenue (Amendment) (No. 2) Ordinance 2015.

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b. A "fund of one" is a popular investment structure, particularly for sovereign wealth funds (SWFs), pension funds, and some other organisations. Therefore, the minimum investor number requirement would limit the marketability of OFCs to these types of investors, and should be removed. The concern surrounding Hong Kong residents using OFCs to avoid Hong Kong tax has already been addressed through the deeming provisions and the number of investors in an OFC should not be relevant.

2. The Bill is silent on the stamp duty implications to onshore privately-offered open-ended fund companies as the Bill is not amending the Stamp Duty Ordinance. This will imply that the existing stamp duty rules would apply such that the transfer of shares in open-ended fund companies would be subject to stamp duty. We suggest the Stamp Duty Ordinance be amended such that the transfer of shares in public and private open-ended fund companies would not be subject to stamp duty.

3. The taxation of performance fees derived by investment managers and carried interest remains a complex and contentious industry issue and is highly fact dependent. The Bill introduces a provision to tax the consideration or remuneration in the form of a dividend for the provision of services in Hong Kong directly or indirectly, which will have flow-on effects and broader implications to the Hong Kong asset management industry. This is an undesirable effect and makes the regime less attractive and competitive. Therefore, we strongly suggest that this matter be considered separately.

4. The measures in Section 20AH(5) of the Bill was not included in the "Proposed extension of profits tax exemption to onshore privately offered open-ended fund companies" issued by the Financial Services and the Treasury Bureau dated 9 March 2017. Section 20AH(5) now requires the OFC to meet the not closely held (NCH) condition within 24 months. It is not possible to retain the tax exemption where the OFC has tried but failed to become NCH within the initial 24 months or is wound up within the initial 24 months because it has not met the NCH condition, despite genuine attempts to do so which satisfy Section 20AI(4). This removal of the first 24 month grace period under 20AH(5) gives rise to significant uncertainty and risk and in our view, funds would not be willing to take on this risk. We would like this position revisited.

5. Other comments included in our submissions to the Financial Services and the Treasury Bureau are set out in **Appendix 1**.

Again, we are grateful for the opportunity to provide our comments on the Bill and would be pleased to provide further details on the above. If you would like more information, please do not hesitate to contact Florence Yip on 2289 1833 or David Kan, Tax Partner, on 2289 3502.

Yours sincerely
For and on behalf of PricewaterhouseCoopers Limited

Florence Yip
Asia Pacific Tax Leader, Financial Services and Asset & Wealth Management

Appendix 1 – Summary of other comments submitted by PwC to the FSTB

1. It is quite common for "qualified investors" to make investments through wholly owned special purpose vehicles (SPVs) rather than making investments directly. Therefore, the definition of "qualified investors" should be extended to include SPVs of such qualified investors. Additionally, the definition of "qualified investors" should be extended to include sovereign wealth funds (SWF) and their SPVs given SWFs are state-owned investment vehicles and may not necessarily be considered "government entities". The Bureau should also consider extending the definition of "qualified investors" to cover other types of institutional investors such as fund of funds and insurance companies.

2. For the "24 + 24" anti-abuse measure that will "dis-apply" the tax exemption for the 24-month start-up period, we consider that safe harbour (similar to the ones for not meeting the NCH condition) should be provided to cover circumstances that are out of control of the fund.

3. For the 10% de minimis limit on non-permissible asset classes, safe harbour should also be available to cover circumstances where an OFC exceeds the 10% de minimis limit due to other temporary and out-of-control circumstances (i.e. in addition to the proposed safe harbour which only addresses significant reduction in value of assets only).

4. As a Hong Kong onshore fund managed by an Securities and Futures Commission licensed corporation, the OFC should undoubtedly be considered a Hong Kong tax resident. Therefore, it should be clearly set out that the Inland Revenue Department will issue tax residency certificates to OFCs that meet the conditions under the proposal.