Bills Committee on Inland Revenue (Amendment) (No. 4) Bill 2017

Responses to written submissions from various organisations to the Bills Committee

	Views	Responses
	General *Organisations: Deloitte, Democratic Alliance for the Betterment and Progress of Hong Kong, The Hong Kong Association of Banks ("HKAB"), The Hong Kong Institute of Chartered Secretaries ("HKICS"), Hong Kong Investment Funds Association ("HKIFA"), The Hong Kong Society of Financial Analysts ("HKSFA"), and PricewaterhouseCoopers ("PwC")*	
1.	The Government's proposal to extend profits tax exemption to onshore privately offered open-ended fund companies (hereafter referred to as "subject OFCs") is supported, as it can level the playing field for onshore and offshore OFCs and promote fund origination in Hong Kong. This can further promote the development of Hong Kong's asset management industry.	The comments are noted. The proposal is a major policy initiative to enhance Hong Kong's attractiveness as a location for the domiciliation and origination of funds.
2.	It should be in Hong Kong's interest to ensure that the proposal is competitive with other comparable jurisdictions. In other jurisdictions where a similar OFC regime exists (e.g. Luxembourg), there is no restriction on the minimum number of investors or level of participation interest for the tax exemption to apply.	The comments are noted. It is our policy intent to attract bona fide privately offered OFCs with a reasonable fund size to Hong Kong, and ensure that an OFC eligible for tax exemption is not owned by only a few individuals or corporate investors. Otherwise, an individual or a corporate investor who is carrying out securities transactions in Hong Kong and subject to profits tax may abuse the tax

Views	Responses
	exemption by repackaging its business as a subject OFC. The various thresholds under the non-closely held ("NCH") condition are necessary to achieve these aims. Nevertheless, we intend to take an incremental approach in setting the different parameters and will review the threshold levels as necessary and as market circumstances may warrant in the future. Meanwhile, it should be noted that in some jurisdictions with a similar corporate fund regime (e.g. Luxembourg and Ireland), the tax regime is different from Hong Kong's in that they practise tax transparency. This means that tax is collected at the investor level, rather than at the fund level. Restrictions on investor number and participation interest may not serve any meaningful purpose in these jurisdictions.
3. The proposal should be as attractive as the existing offshore fund tax exemption.	In formulating the Bill, we are mindful that there may be a higher risk of tax abuse for onshore privately offered funds than offshore ones. This is because residents may be able to convert their taxable profits into non-taxable income via an onshore privately offered fund structure more easily. We have accordingly devised appropriate safeguards and anti-abuse measures, and the requirements and parameters under the proposed tax exemption for the subject OFCs are not the same as those for offshore funds.

Views	Responses
Non-closely Held Condition *Organisations: Deloitte, HKAB, Hong Kong Institute of Certified Public Accountants ("HKICPA"), HKIFA, HKSFA, PwC and The Taxation Institute of Hong Kong ("TIHK")*	
4. The four requirements under the NCH condition that aim to prevent abuse look reasonable, and the safe harbour rules provided seem well-considered.	The comments are noted. To balance the needs for market development and anti-tax abuse, we have carefully considered the proposed parameters under the NCH condition as well as the safe harbour rules.
5. Since no NCH condition is found in the existing profits tax exemption for offshore funds, the proposed NCH condition for the subject OFCs would go against the stated policy objective of the Bill to extend the current profits tax exemption applicable to offshore funds to onshore OFCs. In other words, there would not be a level playing field between onshore and offshore OFCs if an NCH condition is imposed on the former. The Government's aim of using the NCH condition to prevent abuse can and should be sufficiently addressed by the deeming provisions in the new section 20AK, which are reproduced from the deeming provisions under the current section 20AE applicable to offshore funds.	In formulating the Bill, we are mindful that there may be a higher risk of tax abuse for onshore privately offered funds than offshore ones. This is because residents may be able to convert their taxable profits into non-taxable income via an onshore privately offered fund structure more easily. As such, the NCH condition is to prevent this by ensuring that an OFC eligible for tax exemption is not owned by only a few individuals or corporate investors. On the other hand, the deeming provisions under the new section 20AK are to prevent abuse or round-tripping by a resident person disguising as an OFC to take advantage of the exemption. The NCH condition and the deeming provisions serve different purposes. Both would need to be retained.
6. The NCH condition requires a minimum number of investors, which, together with the minimum investment requirement, means that only funds of a	It is our policy intent to attract bona fide privately offered OFCs with a reasonable fund size to Hong Kong, and ensure that an OFC eligible for tax exemption is not owned by only

	Views	Responses
	certain size would be eligible for the regime. While it is appreciated that the aim of these thresholds is to prevent tax abuse, we should not close the door to legitimate OFCs wishing to set up in, or relocate to, Hong Kong because they cannot meet the necessary thresholds. The requirements should be made more flexible to accommodate a range of possible funds and fund sizes.	a few individuals or corporate investors. Otherwise, an individual or a corporate investor who is carrying out securities transactions in Hong Kong and subject to profits tax may abuse the tax exemption by repackaging its business as a subject OFC. The various thresholds under the NCH condition are necessary to achieve these aims. Nevertheless, we intend to take an incremental approach in setting the different parameters and will review the threshold levels as necessary and as market circumstances may warrant in the future.
7.	Although the NCH condition serves as an additional safeguard against tax abuse, the specific requirements in respect of number of investors and participation interest are burdensome. They will also create unnecessary ambiguity on an OFC's tax position, since partial redemption by an investor could be a breach of the NCH condition. Despite the safe harbour rules provided, the requirement to apply to the Commissioner of Inland Revenue ("CIR") and rely on his/her discretion may be burdensome from an administrative perspective.	Please refer to our response to item 6 above.
8.	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	Please refer to our response to item 6 above. Furthermore, a subject OFC with at least one qualifying investor (which includes certain specified types of institutional investors which commonly have a larger

	Views	Responses
	of investors and should be removed. The concern surrounding Hong Kong residents using OFCs to avoid tax has already been addressed through the deeming provisions and the number of investors in an OFC should not be relevant.	number of underlying investors, such as pension funds) is already subject to more relaxed thresholds under the NCH condition.
9.	There should be more clarity either in the Inland Revenue Ordinance (Cap. 112, "IRO") or by way of a Departmental Interpretation and Practice Note ("DIPN") as to whether a "look through" approach should be adopted in determining the number of investors in a master-feeder fund structure. The proposed definition of "investor" in section 20AI of the Bill is not entirely clear whether, in counting the number of investors, such investor refers to the feeder fund itself or the underlying investors of the feeder fund in a master-feeder structure.	"Investor" is defined in the new section 20AI(6) to mean a person who makes capital commitment to a subject OFC, other than the originators or associates. This is the same as the definition in the current section 20AC(6) of the IRO in respect of the offshore private equity fund tax exemption, under which a "see through" approach is not adopted. For a master-feeder fund structure, however, if the feeder fund itself (which invests in a subject OFC) is set up purely to address the needs of investors from different jurisdictions for investment into the OFC, it would not be inappropriate to see through the feeder when counting the number of investors. IRD will provide explanation in a DIPN if necessary.
10.	As it is a common market practice for distributors of funds to pool their client subscription money and invest into funds via a nominee account, it should be made clear in a DIPN that the Inland Revenue Department ("IRD") would not see through the nominee holding to count the number of underlying investors, as this would make the tax exemption virtually impossible to implement.	The comments are noted. As mentioned in our response to item 9 above, we will not generally see through to the underlying investors when counting the number of investors in an OFC. IRD will provide explanation in a DIPN if necessary.

Views	Responses
11. The minimum investment requirements are too high and difficult to be met. For example, for a "normal" investor (i.e. an investor who is not a "qualified investor"), the minimum requirement of $20 million (US$2.58 million) is significantly higher than the normal minimum requirement for typical Cayman Islands funds, which is currently around US$100,000. The minimum investment requirement should be revisited.	Please refer to our response to item 6 above.
12. If a single investor redeems part of its investment, causing the OFC to fall below the required investment threshold of $200 million (for qualified investors) or $20 million each (for other investors), the OFC will lose its tax exemption. Meanwhile, the safe harbours are subject to CIR's discretion. These uncertainties will not encourage OFCs that just meet the minimum requirements to establish in Hong Kong.	Please refer to our response to item 6 above.
13. The restriction that originators and their associates cannot hold more than 30% participation interest in a subject OFC may result in relatively limited room for fund managers or their associates to make seed investments and may not be conducive to the business strategy planning of OFCs.	Please refer to our response to item 6 above.

Views		Responses
Qualified Investors *Organisation: PwC*		
14.	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 the SPVs of such qualified investors.	Under the new section 20AI(6), an "investor" is defined to mean a person who makes capital commitment to a subject OFC, other than the originators or their associates. An SPV can be regarded as an investor if it makes capital commitment to a subject OFC.
15.	The definition of "qualified investors" should be extended to include SWFs and their SPVs, given that SWFs are state-owned investment vehicles and may not necessarily be considered "governmental entities".	SWFs can be regarded as a type of institutional investor which commonly has a larger number of underlying investors and can fall within the definition of qualified investors. On SPVs, please refer to our response to item 14 above.
16.	The Government should consider extending the definition of "qualified investors" to cover other types of institutional investors such as funds of funds and insurance companies.	Under the new section 20AI(6), a "qualified investor" covers publicly offered collective investment schemes authorised by the Securities and Futures Commission ("SFC") and/or other recognised overseas regulators. Funds of funds can fall within this category. On the other hand, insurance companies do not normally have a sufficiently large number of underlying investors. Their inclusion will not be in line with the proposed NCH condition and they will not be regarded as qualified

	Views	Responses
		investors.
	Anti-abuse Measures and Safe Harbour Rules *Organisations: Deloitte and PwC*	
17.	The measures in the new section 20AH(5) was not included in the Government's earlier consultation exercise in March 2017. Section 20AH(5) now requires the OFC to meet the NCH condition within 24 months. It is not possible to retain the tax exemption where: (a) the OFC has tried but failed to become non-closely held within the initial 24 months; or (b) is wound up within the initial 24 months because it has not met the NCH condition, despite genuine attempts to do so. The removal of the first 24-month grace period under section 20AH(5) gives rise to significant uncertainty and risk. This position should be revisited.	We stated in our consultation document of March 2017 that a subject OFC would be "required to continue to meet the NCH condition for a further period of 24 months after the first 24-month period. Otherwise, we would "dis-apply" the tax exemption and the OFC would then be chargeable to tax for the 24-month start-up period". This allows a subject OFC to have (the first) 24 months to establish a track record and attract investors. The OFC is required to meet the NCH condition for a further 24 months to prevent potential tax leakage, in particular to prevent individuals or entities from taking advantage of the tax exemption in the first 24-month period (e.g. by repeatedly opening and closing a subject OFC every 24 months). Should a subject OFC fail to meet the NCH condition due to circumstances such as winding-down of activities or temporary and out-of-control circumstances, it can apply to CIR under the safe harbour in the new section 20AJ(1) for tax exemption.

	Views	Responses
18.	For the anti-abuse measure under which the tax exemption for the 24-month start-up period will be "dis-applied", a safe harbour should be provided to cover circumstances that are out of an OFC's control.	A safe harbour is provided under the new section 20AJ(1), under which CIR has the discretion to grant tax exemption to a subject OFC should it fail to meet the NCH condition due to temporary and out-of-control circumstances.
19.	For the 10% *de minimis* limit on "non-permissible asset classes", a safe harbour should be available to cover circumstances where an OFC exceeds the 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).	A safe harbour is provided under the new section 20AJ(2), under which CIR may grant tax exemption to a subject OFC if it fails to stay within the 10% *de minimis* limit, provided that this failure is "temporary and due to circumstances not reasonably foreseeable by the company, <u>including</u> (a) fluctuations in the value of the assets of the company; and (b) redemptions by investors beyond the company's control". The wording is not meant to be exhaustive and should be able to encompass other temporary and out-of-control circumstances.
20.	The deeming provisions would be triggered if a resident person, alone or together with any of its associates, holds 30% or more of beneficial interest in an OFC. Based on the proposed section 20AK, it appears that this 30% threshold would apply to the OFC as a whole rather than at each sub-fund level. This is because the wording of section 20AK makes reference to "open-ended fund company" instead of "sub-fund". If that is the case, there appears to be an inconsistency with the new section 20AG, which provides that each sub-fund be treated individually.	Under the new section 20AG(1)(b)(iii), the provisions of Part 4 (Profits Tax) of the IRO apply to a sub-fund as if it were an OFC for computing the assessable profits of the sub-fund. Therefore, section 20AK will apply to each sub-fund (for sub-funds of OFCs) and OFC (for OFCs without sub-funds) alike. Accordingly, there is no inconsistency between sections 20AG and 20AK.

	Views	Responses
	More clarity in this area is needed.	
21.	Unlike the existing offshore fund tax exemption regime where the deeming provisions will not be triggered if the offshore fund is bona fide widely held, no similar safe harbour rule is included in the Bill. This differential treatment may give rise to concerns to industry players considering Hong Kong for the domiciliation of their funds. Further consideration of a safe harbour would be helpful.	Please refer to our response to item 5 above. For the deeming provisions, we see no ground to provide a safe harbour.
	Taxation of Investment Managers *Organisations: Deloitte, HKICPA, HKIFA, Joint Liaison Committee on Taxation, PwC and TIHK*	
22.	The taxation of performance fees and carried interest derived by investment managers remains a complex and contentious issue in the industry. It should be considered on a case-by-case basis as it is highly fact-dependent. The new section 20AJ(3) to tax consideration or remuneration received in the form of dividends may have unintended implications. Therefore, the matter should be considered separately.	A subject OFC is chargeable to tax in respect of profits derived from transactions in "non-permissible asset classes". Therefore, the current section 26(a) of the IRO, which exempts dividends from taxation if the company is chargeable to profits tax, will apply. It is necessary to add an express provision (i.e. the new section 20AJ(3)) to ensure that performance fees and carried interest received by OFC investment managers for services rendered in Hong Kong would not be exempted from profits tax under section 26(a) even though they are paid out in the form of dividend. The new section 20AJ(3) does not affect the general tax principles that are currently applicable in determining

Views	Responses
	whether carried interest or performance fees are taxable.
23. Remuneration that is subject to tax in the hands of the recipient is generally deductible to the payer, thus avoiding double taxation of the same income. On the other hand, dividends are not deductible as per the current tax policy. As a result, the proposal under section 20AJ(3) will create a double taxation problem, as it does not allow the payer company to deduct its dividend expenses. It is thus necessary to add a provision to entitle the payer company to deduct the amount of any dividend which will be taxed under the new section 20AJ(3), or remove section 20AJ(3) altogether. The result of either solution is that no net tax will be payable, which is the same general treatment afforded to all forms of remuneration paid by a taxpaying entity.	The new section 20AJ(3) does not affect the general tax principles that are currently applicable in determining whether carried interest or performance fees are taxable. It also does not affect the current treatment of expense deduction, i.e. the consideration or remuneration (e.g. management/performance fees) paid to investment managers and charged in the accounts of an OFC as an expense would be allowed for tax deduction for the OFC to the extent that it has been incurred for producing chargeable profits. Accordingly, the issue of double taxation would not arise.
24. For the offshore PE fund regime, there is no anti-avoidance provision similar to the new section 20AJ(3). Also, the new section appears to go against the principles set out in DIPN No. 51, which states that management/performance fees received by investment managers for services rendered in Hong Kong will be assessed (a) on the basis of applying the general anti-avoidance provisions and (b) only where the investment managers or advisors are not adequately remunerated for their services or the	Section 26(a) of the IRO provides for profits tax exemption of dividends received from corporations which are chargeable to profits tax. Since an offshore PE fund is not chargeable to tax under the offshore PE fund regime, section 26(a) does not apply and the management fees and carried interest paid out in the form of dividend remain taxable. Therefore, it is not necessary to add a specific provision similar to new section 20AJ(3) under the offshore PE fund regime.

	Views	Responses
	distributions received by them are not on an arm's length basis. The Government should justify the different tax treatments for subject OFCs and offshore PE funds.	Please refer to item 22 above on why the new section 20AJ(3) is needed for the subject OFCs. In DIPN No. 51 on "Profits tax exemption for offshore private equity funds", IRD has provided explanations regarding the taxation of investment managers. The explanations therein are relevant to all types of fund structures, including limited partnerships, unit trusts, mutual funds and OFCs, whether onshore or offshore. Investment managers, whether acting for the subject OFCs or offshore PE funds, are assessed to tax in respect of their income derived from services rendered in Hong Kong.
25.	The Government should clarify its views on the following two issues: (a) whether the current section 26(a) of the IRO applies to dividends paid out from an OFC that is chargeable to but exempt from the payment of profits tax (i.e. in the case where the OFC qualifies for the profits tax exemption) and (b) if yes, based on the current drafting of the new section 20AJ(3), it seems that the section cannot achieve the legislative intent of the Government (i.e. remuneration in the form of dividends received by investment managers for providing any services in the ordinary course of a trade or business carried out in Hong Kong will be chargeable to profits tax), because the section will not apply when an OFC is chargeable to but exempt from payment of profits tax.	Section 26(a) of the IRO does not apply to an OFC exempt from the payment of tax (i.e. not chargeable to tax) which derives its profits wholly from transactions in asset classes specified in Schedule 16A. Therefore, performance fees and carried interest paid out in the form of dividends to investment managers will continue to be chargeable to tax. Section 26(a) applies to an OFC chargeable to tax in respect of profits derived from transactions in "non-permissible asset classes" subject to the 10% *de minimis* limit. Without the new section 20AJ(3), performance fees and carried interest paid out in the form of dividends to investment managers will be exempt from tax although such fees and interests are essentially income or profits derived from management services rendered in Hong Kong. Therefore, it is necessary

Views	Responses
	to add the new section 20AJ(3) to ensure that performance fees and carried interest in the form of dividends received by OFC investment managers for services rendered in Hong Kong will not be exempted from profits tax under section 26(a).
26. The proposed section 20AJ(3) seems to be asymmetrical and potentially inequitable, as dividend income received by the investment manager has to be taxed, while the OFC can be exempt from profits tax.	Even though the OFC is exempt from profits tax, it does not necessarily mean that consideration or remuneration (e.g. management/performance fees) received by the investment manager is not taxable. Since the investment manager provides services in Hong Kong, consideration or remuneration that the investment manager received (including that in the form of a dividend) from an OFC for the services rendered should be chargeable to tax.
27. Taxing performance fees and carried interest as normal assessable income or profit may not attract more asset managers to set up business in Hong Kong. The Government should consider taxing the performance fees and carried interest at a reduced rate of profits tax (say 10%) for qualified Hong Kong asset managers.	The comments are noted. The suggestion may have wider implications on Hong Kong's tax policy and is outside the scope of the Bill.
28. IRD should clarify in a DIPN that dividends or distributions derived from genuine seed capital investments made by investment managers to support the fund at the start-up phase (which is a common practice in the industry) will be exempt from tax	It is not operationally feasible to distinguish between "seed" capital investments and "normal" investments. We do not consider it appropriate to propose tax concession for seed investments made by investment managers.

Views	Responses
pursuant to the existing tax provisions.	
Stamp Duty Treatment *Organisations: HKICPA, HKIFA and PwC*	
29. The Bill is silent on the stamp duty implications on subject OFCs. This implies that the existing stamp duty rules would apply such that the transfer of shares in OFCs would be subject to stamp duty. The Stamp Duty Ordinance (Cap. 117, "SDO") should be amended such that the transfer of shares in publicly and privately offered OFCs would not be subject to stamp duty.	The stamp duty treatment of OFCs has already been dealt with in the Securities and Futures (Amendment) Ordinance 2016 ("the 2016 Amendment Ordinance") passed by the Legislative Council in June 2016. The SDO has been amended to provide that the existing stamp duty treatment of unit trusts be applied to OFCs. This means that stamp duty exemption is given to: (a) all transfers of shares of listed OFCs which are exchange-traded funds; and (b) transfers of shares of unlisted OFCs by way of allotment and redemption. As we understand it, the transfers of unlisted OFC shares are usually effected by way of allotment and redemption. Stamp duty is waived for such transfers.
30. If the existing stamp duty regime for unit trusts is to apply to OFCs, this will be a less favourable treatment than the offshore funds regime, as transfers of units/shares in offshore funds are not subject to stamp duty in Hong Kong.	Shares in offshore funds (in the form of a corporate) do not normally fall within the meaning of "Hong Kong stock" under section 2 of the SDO. Sales or purchases of such shares are accordingly not subject to stamp duty under section 19 of the SDO. Given that the situs of the registers of onshore unit trusts/OFCs is located in Hong Kong, their stamp duty treatment should not be compared with that of offshore funds.

Views	Responses
Base Erosion and Profit Shifting ("BEPS") *Organisations: Deloitte and HKICPA*	
31. Under BEPS Action 5, a preferential regime may be considered a harmful tax practice if it is ring-fenced from the domestic market.[1] As the deeming provisions are only applicable to residents, the proposed regime may be considered to have a ring-fencing feature and thus a harmful tax practice by the Organisation for Economic Co-operation and Development ("OECD"). Further consideration should be given to address a possible challenge by OECD's Forum on Harmful Tax Practices ("FHTP").	The proposed tax regime should not be in violation of the BEPS principles for the following reasons – (a) the proposed tax regime for subject OFCs is not within the scope of the work of the OECD FHTP; (b) the proposed tax regime can be regarded as not ring-fenced since the OFC can be 100% beneficially owned by investors resident in Hong Kong; (c) the proposed tax regime provides tax exemption to subject OFCs at the fund level and not at the investor level (i.e. non-resident investors continue to be subject to taxation in their jurisdictions of residence whereas resident investors will be subject to profits tax in Hong Kong if their interests in the OFC equal or exceed 30%); and (d) a non-resident generally may not be subject to Hong

[1] Countering harmful tax practice (Action 5) is one of the minimum standards under the BEPS package of the Organisation for Economic Co-operation and Development. This BEPS Action seeks to revamp the work on harmful tax practices with priority on improving transparency and on requiring substantial activity for any preferential tax regime.

Views	Responses
	Kong profits tax under a double tax agreement in the absence of a permanent establishment.
32. The Government indicated that the proposed regime should not be regarded as a harmful tax practice by OECD in the context of BEPS action plans. The situation should continue to be monitored so as to reduce the risk of having to reappraise the proposed measures within a short space of time, due to subsequent interpretations or developments internationally.	The comments are noted. The Government will continue to monitor the latest developments in the international community.
Other Issues *Organisations: Deloitte, HKAB, HKICS and PwC*	
33. An OFC with sub-funds will be treated as a single taxable "person" under section 2 of the IRO, meaning that tax returns will need to be filed at the OFC level based on the consolidated assessable profits of the sub-funds. This raises the confusion of whether an OFC is required to pay for the tax liability of a sub-fund that has already been fully redeemed. If yes, this would mean that the tax liability of that redeemed sub-fund will have to be paid out of the assets of the remaining sub-funds. This would contradict the proposed section 20AG(2), which stipulates that the part of the profits tax attributable to the assessable	Since a sub-fund is not a legal person, the new sections 20AG(1)(a) and (2) specifically provides that a main company will be liable for the profits tax attributable to each of its sub-funds; and any profits tax liability attributable to a sub-fund must only be discharged out of the assets of the sub-fund. Pursuant to section 112S of the Securities and Futures Ordinance (Cap. 571, "SFO"), the assets of a sub-fund cannot be used to discharge the liabilities under the IRO of the main company or any other sub-fund, and any liability incurred on behalf of a sub-fund may only be discharged out of its own assets.

	Views	Responses
	profits of a sub-fund may only be paid out of the assets of that sub-fund. The matter should be clarified either in the IRO by amending the definition of "person" in section 2, or in a DIPN.	It is envisaged that all accounts of an OFC (including its sub-funds, if any) must be prepared in compliance with the Hong Kong Financial Reporting Standards or International Financial Reporting Standards pursuant to which an OFC (including its sub-funds, if any) should recognise contingent liabilities. Further, when an OFC (or its sub-funds) applies to the SFC for termination, the board of directors has to provide a solvency statement confirming that the OFC or sub-fund will be able to meet all its liabilities (including tax liabilities) within 12 months from the date of the solvency statement. Also, the board has to annex an auditor's opinion that the directors' confirmation in the solvency statement is not unreasonable. Therefore, it is generally expected that before a sub-fund is fully redeemed, provisions for profits tax payable should be set aside to facilitate the subsequent settlement of its tax liabilities by the main company. The above requirements will be set out in the SFC's OFC Code. We consider it not necessary to amend the definition of "person" in section 2 of the IRO. IRD will provide explanation in a DIPN if necessary.
34.	The proposed permissible asset classes are too restrictive. The scope should be expanded to cover other asset classes, such as real estate, insurance policies, loan participants, investments in shares of Hong Kong private companies and other investments.	An OFC will be established under the SFO. In line with section 112Z of the 2016 Amendment Ordinance, an OFC should engage an investment manager licensed by or registered with the SFC to carry out Type 9 (asset management) regulated activity. Consequently, the

Views	Responses
	investment scope of an OFC should align with such regulated activity (i.e. mainly securities and futures). Meanwhile, in view of the asset classes in which privately offered funds would commonly invest, privately offered OFCs will further be allowed to invest in foreign exchange contracts, bank deposits, foreign currencies, certificates of deposit and cash. The proposed investment scope has taken into account that the primary purpose of an OFC would be to operate as an investment fund and the OFC is not designed to operate as a corporate entity for the purposes of general commercial business or trade. We consider that the proposed permissible asset classes should be able to accommodate a very substantial part of the asset classes that privately offered OFCs normally invest in (including loans or distressed debt structured in the form of securities). Also, to give further flexibility, a *de minimis* limit of 10% of a privately offered OFC's gross asset value is provided for investments in asset classes other than those mentioned above.
35. There are other resident fund entities, such as resident unit trusts, which would not be covered by the proposal. In the interest of promoting its asset and fund management industry, Hong Kong should enact a new tax exemption legislation to cover all types of	The OFC regime is a new initiative with the aim of attracting funds to domicile in Hong Kong. Our current focus is to make the OFC regime attractive by providing a more facilitating tax environment for OFCs. Nevertheless, the suggestion is noted and will be taken into account when the

Views		Responses
	resident privately offered funds, regardless of whether they are OFCs incorporated under the SFO. Nevertheless, in the interim, the Bill is a step in the right direction.	Government formulates policies to promote the asset management industry in the future.
36.	As a Hong Kong onshore fund managed by an SFC-licensed corporation, a subject OFC should undoubtedly be considered a Hong Kong tax resident. Therefore, it should be clearly set out that IRD will issue tax residency certificates to OFCs that meet the conditions under the proposal.	Generally, IRD expects that an OFC incorporated under the SFO carrying on business in Hong Kong should qualify as a Hong Kong tax resident. As per the established practice, before deciding whether a Certificate of Resident Status can be issued, IRD has to collect detailed information to substantiate whether the beneficial ownership requirement, the principal purpose test and the limitation of benefits provisions are satisfied so as to prevent treaty abuse and to protect Hong Kong's reputation as a responsible treaty partner.
37.	The four conditions that a subject OFC is required to meet in order to enjoy tax exemption are agreeable. However, when considering whether an OFC is a resident person (i.e. Condition 1), IRD should consider the practice of Hong Kong's major competitors, such as Singapore which has recently tightened its residency requirements.	In determining whether an OFC is a resident person, the statutory definition in the existing section 20AB(2)(b) of the IRO is adopted. That is, an OFC is regarded as a resident person if its central management and control ("CMC") is exercised in Hong Kong. The CMC test is a well-established common law rule to determine the residence of corporations, partnerships and trust estates.

Financial Services and the Treasury Bureau
Inland Revenue Department
29 December 2017