

II. REPORT

The date of First Reading of the Bill is 28 June 2017. Members may refer to the Legislative Council ("LegCo") Brief (File Ref.: ASST/3/1/5/1C(2017)Pt.6) issued by the Financial Services and the Treasury Bureau on 21 June 2017 for further details.

Object of the Bill

2. The Bill seeks to amend the Inland Revenue Ordinance (Cap. 112) to extend profits tax exemption to certain open-ended fund companies ("OFCs"), the central management and control of which is exercised in Hong Kong; and to provide for related matters.

Background

3. By the Securities and Futures (Amendment) Ordinance 2016 (Ord. No. 16 of 2016) ("SFAO"), the Securities and Futures Ordinance (Cap. 571) was amended to provide for the incorporation, registration, management, operation and regulation of OFCs. "OFC" is defined in section 112A of Cap. 571 as a collective investment scheme constituted as a corporation that holds a certificate of incorporation issued by the Registrar of Companies. SFAO has not been brought into operation.

4. During the deliberation of the Bills Committee formed to study the Securities and Futures (Amendment) Bill 2016, the Administration explained that when the OFC regime in SFAO comes into operation, the existing profits tax exemption for public funds under Cap. 112 would apply to publicly offered OFCs. For privately offered OFCs, profits tax exemption would be available under the existing regime if the OFCs were offshore funds with their central management and control located outside Hong Kong.

5. According to paragraph 4 of the LegCo Brief, as onshore privately offered OFCs cannot enjoy the same tax exemption as publicly offered OFCs, the Administration considers it a disincentive for fund domiciliation and management in Hong Kong and it is necessary to remove the distinction by amending Cap. 112.

Provisions of the Bill

6. The Bill seeks to amend Cap. 112 to extend profits tax exemption to certain onshore privately offered OFCs. The proposed amendments are summarized in the following paragraphs.

Eligibility for profits tax exemption

7. The Bill proposes to add a new section 20AH to exempt an OFC ("subject OFC") from paying profits tax on its assessable profits in relation to certain transactions if certain conditions are met (or regarded under Part 4 of Cap. 112 as having been met) at all times during the basic period for a year of assessment.

8. Under the proposed new section 20AH(3), a transaction is eligible for profits tax exemption if it is a transaction in assets of a class specified in the new Schedule 16A ("Schedule 16A class", such as securities and futures contracts as defined under Cap. 571) and the activities that produce assessable profits from the transaction are carried out or arranged in Hong Kong by or through qualified persons, namely, corporations or authorized financial institutions licensed or registered under Cap. 571 to carry on asset management business.

9. The Bill proposes that a subject OFC has to satisfy the following conditions in order to qualify for profits tax exemption:

- (a) the subject OFC is a resident person¹;
- (b) the subject OFC is non-closely held ("NCH", as defined in the proposed new section 20AI); and
- (c) the trade, profession or business carried on by the subject OFC in Hong Kong either does not involve transactions in assets of a non-Schedule 16A class or involves transactions in assets of a non-Schedule 16A class not exceeding 10% of the value of all the subject OFC's asset.

10. Under the proposed new section 20AI, a subject OFC is NCH if certain conditions are met. These conditions include, among others, the requirements on the number of investors and the relevant percentages of

¹"Resident person" is defined in section 20AB(2)(b) of Cap. 112. It includes, among others, where a person is a corporation not being a trustee or trustee estate, the person is regarded as a resident person if its central management and control is exercised in Hong Kong.

participation interests of various types of investors, which are specified in the new Schedule 16B. Under the proposed new section 20AI(5), Schedule 16B may be amended by the Commissioner of Inland Revenue by notice published in the Gazette.

11. The proposed new section 20AH(5) to (7) provide for certain circumstances under which the profits tax exemption of a subject OFC would be regarded as never having been granted, e.g. the subject OFC has not become NCH within 24 months after the date on which it accepts its first investor.

Provisions on assessable profits of subject OFCs

12. The Bill also proposes to introduce provisions in relation to the computation of the assessable profits of a subject OFC, such as the treatment of sub-fund held by a subject OFC (the proposed new section 20AG), treating the assessable profits of a subject OFC as a resident person under certain circumstances (the proposed new section 20AK), the treatment of loss sustained by a subject OFC in the computation of its assessable profits (the proposed new section 20AL) .

Commencement

13. Except for item 8 of the new Schedule 16A in relation to OTC derivative products as defined in Part 1 of Schedule 1 to Cap. 571, which would come into operation on the day to be appointed for the commencement of section 53(8)² of the Securities and Futures (Amendment) Ordinance 2014 (Ord. No. 6 of 2014), the Bill, if passed, would come into operation on a day to be appointed for the commencement of SFAO.

Public Consultation

14. According to paragraph 21 of the LegCo Brief, the Administration consulted the industry from January to April 2016 and in March 2017 on the proposal to extend profits tax exemption to subject OFCs. The industry generally welcomed the proposal. Most comments received were on technical parameters.

² Section 53(8) of Ord. No. 6 of 2014 adds "OTC derivative products management" to the definition of "asset management" (Type 9 regulated activity) in Part 2 of Schedule 5 to Cap. 571.

Consultation with LegCo Panel

15. As advised by the Clerk to the Panel on Financial Affairs, the Panel was briefed on 16 March 2017 on the legislative proposal to extend profits tax exemption to subject OFCs. Members discussed issues including the NCH condition that subject OFCs were required to meet, measures to prevent possible abuse and impact of the proposal on tax revenue. Members had no objection to the introduction of the Bill into LegCo.

Conclusion

16. The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. In view of the issues raised by members of the Panel on Financial Affairs, Members may wish to consider whether a Bills Committee should be set up to study the Bill in detail.

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