

The logo for the Alternative Investment Management Association (AIMA) features the acronym "AIMA" in white, bold, sans-serif capital letters. The text is centered within a dark blue rectangular field. Below this field is a horizontal bar with a color gradient from dark blue on the left to magenta on the right.

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Mr. Stephen Lo
Principal Assistant Secretary

Treasury Branch
Financial Services and the Treasury Bureau

Sent via email

23 February 2018

Dear Mr. Lo

Inland Revenue (Amendment) (No. 6) Bill 2017

The Alternative Investment Management Association (AIMA)¹ wishes to provide comments on the implementation of BEPS measures as proposed in the Inland Revenue (Amendment) (No. 6) Bill 2017 (Bill).

We support the policy decision to adopt BEPS measures to the minimum standard required by the BEPS Final Reports. We consider that it is important that Hong Kong's tax system should be compliant with international standards but the government should not seek to apply measures that exceed these standards if this would affect Hong Kong's competitive position.

We limit our specific comments to the following issues which have particular relevance for the investment management sector.

1. Position of fee arrangements between funds and fund managers under transfer pricing rules

It is typical in the fund management industry that the fund manager is responsible for the management of the fund's investment and other affairs. Further, it is common that the fund manager would hold any management shares in the fund which confer rights in relation to the conduct of the statutory affairs of the fund. Consequently, it is likely that the fund and its fund manager would meet the "participation condition" under Section 50AAH(2)(b) and hence become "associated persons". Accordingly, under the provisions introduced by the Bill, the fund and the fund manager would need to conduct a transfer pricing study to justify that the

¹ AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 1,900 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than US\$2 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 80 members that manage US\$500 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org.

fees payable by the fund to the fund manager are at arm's length and are subject to the potential risk that the IRD would challenge the pricing and make transfer pricing adjustments.

However, the reality of the position is that the amount of the fees are set under the terms of the subscription arrangements made by the fund with the third-party investors who thereby agree the fees when deciding to invest in the fund. Thus, the fees payable by the fund to the fund manager are set at arm's length through the arrangements with the investors, although by definition, the fund and the investment manager should be considered associated persons.

We request that this should be acknowledged by the IRD in the application of the transfer pricing rules to the commercial arrangements between the fund and the fund manager so that the legislation does not create additional, unnecessary tax compliance burdens for the fund and fund manager (with consequent administrative obligations for the IRD), and the concern that unreasonable transfer pricing adjustments could be imposed will be avoided.

2. Application of transfer pricing rules to salaries tax

The Bill proposes that transfer pricing rules would be applicable to salaries tax. We believe that this is impracticable and would distort business decisions.

For fund managers, as with many other privately-owned businesses, the principal / owner may choose to draw a low salary for any of a number of commercial reasons (e.g., the company is in loss position in early years, the company needs to maintain capital, perhaps for regulatory purposes, or the company needs to finance an expansion of its activities). The principal/owner also has a legitimate choice between being rewarded as an employee of the business or as an equity owner which it is not appropriate for transfer pricing rules to set aside.

If transfer pricing rules are applied for the purposes of salaries tax such that the key principal / owner would be deemed to earn an amount of salary which is equal to the amount a regular employee in that role should receive, this would create an economic hardship to the principal / owner and would make Hong Kong less attractive as a fund management hub. In our view, the proposed transfer pricing rules should not be applied to salaries tax, and this is consistent with the practice in many jurisdictions worldwide.

3. Matters on which to seek clarification

- a) Since an arm's length amount is not a single fixed amount, the IRD should provide confirmation that an arrangement that falls within the arm's length range determined in accordance with the relevant OECD guidelines would meet the requirements of the legislation.
- b) Under the proposed Section 50AAK and Schedule 17G, the activities of a fund manager may create a permanent establishment in Hong Kong of a fund such that profits of the fund should be attributed to the permanent establishment in Hong Kong which may have Hong Kong profits tax implications. We request that the IRD should confirm that the profits tax exemption under Sections 20AC, 20ACA, and 26A would override Section 50AAK in these circumstances.

Should you require any further explanation of these issues, we would be pleased to provide this.

Yours faithfully,



Lee Kher Sheng
Managing Director
Co-Head of APAC
Deputy Global Head of Government Affairs