

LEGISLATIVE COUNCIL BRIEF

Inland Revenue Ordinance (Cap 112)

INLAND REVENUE ORDINANCE (AMENDMENT OF SCHEDULE 16) NOTICE 2018

INTRODUCTION

At the meeting of the Executive Council on 24 April 2018, the Council **ADVISED** and the Chief Executive **ORDERED** that the Inland Revenue Ordinance (Amendment of Schedule 16) Notice 2018 (“the Notice”) at **Annex A** should be made.

A

JUSTIFICATIONS

Launch of the Scheme

2. Funding of \$2 billion for the Innovation and Technology Venture Fund (“ITVF”) Scheme (“the Scheme”) was approved by the Finance Committee of the Legislative Council (“LegCo”) on 12 July 2016 for the Government to co-invest on an approximately 1:2 ratio with Venture Capital (“VC”) funds in local innovation and technology (“I&T”) start-ups so as to build a more vibrant I&T ecosystem in Hong Kong.

3. On 15 September 2017, we openly invited VC funds to become partner funds of the Scheme. By the close of application on 15 January 2018, applications from 14 VC funds have been received.

Tax Concern of Offshore VC Funds

4. Some offshore VC funds have expressed concern over a potential tax issue in relation to the Scheme. Under section 20AC(3) of

the Inland Revenue Ordinance (“IRO”), non-resident persons exempted from profits tax chargeable in respect of their assessable profits from –

- (a) transactions specified in Part 1 of Schedule 16 to the IRO (Specified Transactions)¹ which have been carried out through or arranged by a “specified person”², or that the non-resident persons concerned are “qualifying funds”³; and
- (b) transactions incidental to the carrying out of such Specified Transactions

may lose the tax exemption status if they carry on any trade, profession or business in Hong Kong other than those transactions. A transaction in the shares of “private companies”⁴ which are not “special purpose vehicles”⁵ or “excepted private companies”⁶ is currently not a Specified Transaction.

B Please refer to **Annex B** for the terms mentioned above as defined in section 20AC(6) and section 20ACA(2) of the IRO.

5. Many offshore VC funds are concerned that by co-investing with the Government under the Scheme, they would lose the profits tax exemption status, meaning that, potentially, all the profit arising from investment in and outside Hong Kong may become taxable profits under the present taxation regime. VC funds consider that this would limit their participation in and the success of the Scheme.

Proposed Legislative Amendments

6. To address the above concern, we propose to: (a) add a transaction in an investee company’s shares carried out through or arranged by a specified person for, or carried out by, a non-resident partner fund as a new type of “Specified Transaction” to Part 1 of Schedule 16 to the IRO to cover the transactions in relation to the Scheme; and (b) insert the relevant definitions (e.g. “investee company” and “non-resident partner fund”) in Part 2 of Schedule 16 to the IRO.

¹⁻⁶ Please refer to Annex B for the definition.

7. To qualify for the exemption under the current proposal, the offshore VC fund concerned must be –

- (a) a non-resident person (within the meaning of section 20AB(3) of the IRO); and
- (b) a qualifying fund (as defined in section 20AC(6) of the IRO) or that the relevant transactions have been carried out through or arranged by a specified person (as defined in section 20AC(6) of the IRO).

8. Section 20AC(5) of the IRO provides that the Commissioner of Inland Revenue may amend Schedule 16 to the IRO by notice published in the Gazette. The Financial Services and the Treasury Bureau has no objection to the proposed amendments. The Securities and Futures Commission has also been informed of the proposed changes.

9. The proposed provision of tax incentive is open to offshore VC funds but not to their onshore equivalent which currently do not enjoy any tax exemption under the prevailing tax regime. As announced by the Financial Secretary in the 2018-19 Budget, the Government has commenced a review of the existing tax concession arrangements applicable to the fund industry having regard to international requirements on tax co-operation. Whether the proposed tax incentive to offshore VC funds should be extended to their onshore equivalent would be considered in that context.

THE INLAND REVENUE ORDINANCE (AMENDMENT OF SCHEDULE 16) NOTICE 2018

10. The main purpose of the Notice is to add a new transaction to the list of transaction specified in Part 1 of Schedule 16 to the IRO and the relevant definitions to Part 2 of Schedule 16 to the IRO.

LEGISLATIVE TIMETABLE

11. The legislative timetable will be as follows:

Publication in the Gazette

27 April 2018

Tabling at LegCo (for negative vetting) 2 May 2018

Commencement of the Notice 22 June 2018

IMPLICATIONS OF THE PROPOSAL

C 12. The proposal has financial, civil service and sustainability implications as set out at **Annex C**. It is in conformity with the Basic Law, including the provisions concerning human rights. The proposal will not affect the binding effect of the existing provisions of the IRO and its subsidiary legislation. It has no productivity, environmental, economic, gender or family implications.

PUBLIC CONSULTATION

13. We consulted the major VC associations and professional bodies in accountancy/tax in the fourth quarter of 2017. They generally welcome the proposal.

PUBLICITY

14. We will issue a press release on the Notice on 27 April 2018. A spokesperson will be available to answer media and public enquiries.

ENQUIRIES

15. Enquiries on this Brief can be addressed to Mr Wong Wang-wah, Assistant Commissioner for Innovation and Technology (Infrastructure and Quality Services) at 2810 2753.

Innovation and Technology Bureau
Innovation and Technology Commission
25 April 2018

Inland Revenue Ordinance (Amendment of Schedule 16) Notice 2018

(Made by the Commissioner of Inland Revenue under section 20AC(5) of the Inland Revenue Ordinance (Cap. 112))

1. Commencement

This Notice comes into operation on 22 June 2018.

2. Inland Revenue Ordinance amended

The Inland Revenue Ordinance (Cap. 112) is amended as set out in section 3.

3. Schedule 16 amended (specified transactions)

- (1) Schedule 16, English text, Part 1, items 1, 2, 3, 4, 5 and 6—

Repeal

“a transaction”

Substitute

“A transaction”.

- (2) Schedule 16, Part 1—

Add

“7. A transaction in an investee company’s shares carried out through or arranged by a specified person for, or carried out by, a non-resident partner fund.”.

- (3) Schedule 16, English text, Part 2, section 1, definition of *share*—

Repeal the full stop

Substitute a semicolon.

- (4) Schedule 16, Part 2, section 1—

Add in alphabetical order

“*investee company* (獲投資公司) means—

- (a) a corporation that has ITVFC and a partner fund as shareholders under the ITVF Scheme; or
- (b) a corporation that—
 - (i) had, at any time, ITVFC and a partner fund (*Fund A*) as shareholders under the ITVF Scheme; and
 - (ii) has, since that time, continued to have a partner fund (whether Fund A or another partner fund) as a shareholder;

ITVF Scheme (創基計劃) means the Innovation and Technology Venture Fund Scheme established by the Innovation and Technology Commission;

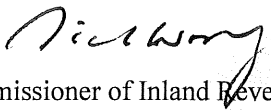
ITVFC (創基公司) means The Innovation and Technology Venture Fund Corporation incorporated under the Companies Ordinance (Cap. 622);

non-resident partner fund (非居港夥伴基金) means a partner fund that is a non-resident person within the meaning of section 20AB(3);

partner fund (夥伴基金) means a fund that is a party (whether or not through an agent) to an agreement—

- (a) to which ITVFC is also a party;
- (b) that stipulates the overall rights and obligations of ITVFC and the fund in respect of their participation in the ITVF Scheme; and
- (c) that is valid and in force;

specified person (指明人士) has the meaning given by section 20AC(6).”.


Commissioner of Inland Revenue

24. 4. 2018

Explanatory Note

Under subsection (1) of section 20AC of the Inland Revenue Ordinance (Cap. 112) (*Ordinance*), a non-resident person is exempt from profits tax in respect of the person's assessable profits from transactions specified in Part 1 of Schedule 16 to the Ordinance (*Part 1*) if certain conditions set out in that section are satisfied.

2. The main purpose of this Notice is to add a new transaction to the list of transactions specified in Part 1. Minor textual amendments are also made to the English text of Part 1.

Definitions Extracted from the IRO

Term	Reference in the IRO	Definition
“specified person”	Section 20AC(6)	In relation to a transaction carried out on or after 1 April 2003, a corporation licensed under Part V of the Securities and Futures Ordinance (Cap 571) to carry on, or an authorized financial institution registered under that Part for carrying on, a business in any regulated activity as defined by Part 1 of Schedule 5 to that Ordinance.
“qualifying funds”	Section 20AC(6)	A fund that falls within the following descriptions – (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) the portion of the net proceeds arising out of the transactions of the fund to be received by the originator and the originator’s associates, after deducting the portion attributable to their capital contributions (which is proportionate to that attributable to the investors’ capital contributions), is agreed under an agreement governing the operation of the fund to be an amount not exceeding 30% of the net proceeds;

Annex B

Term	Reference in the IRO	Definition
“Specified Transactions”	Part 1 of Schedule 16	(1) a transaction in securities. (2) a transaction in futures contracts. (3) a transaction in foreign exchange contracts. (4) a transaction consisting in the making of a deposit other than by way of a money-lending business. (5) a transaction in foreign currencies. (6) a transaction in exchange-traded commodities.
“private company”	Section 20ACA(2)	A company incorporated in or outside Hong Kong that is not allowed to issue any invitation to the public to subscribe for any shares or debentures of the company.
“special purpose vehicle”	Section 20ACA(2)	A corporation, partnership, trustee of a trust estate or any other entity that - (a) is wholly or partially owned by a non-resident person; (b) is established solely for the purpose of holding, directly or indirectly, and administering one or more excepted private companies; (c) is incorporated, registered or appointed in or outside Hong Kong; (d) does not carry on any trade or activities except for the purpose of holding, directly or indirectly, and administering one or more excepted private companies; and (e) is not itself an excepted private company.

Annex B

Term	Reference in the IRO	Definition
“excepted private company”	Section 20ACA(2)	<p>A private company incorporated outside Hong Kong that, at all times within the 3 years before a transaction falling within subsection (1)(a), (b) or (c) of section 20ACA is carried out —</p> <p>(a) did not carry on any business through or from a permanent establishment in Hong Kong;</p> <p>(b) falls within either of the following descriptions—</p> <ul style="list-style-type: none">(i) it did not hold (whether directly or indirectly) share capital (however described) in one or more private companies carrying on any business through or from a permanent establishment in Hong Kong;(ii) it held such share capital, but the aggregate value of the holding of the capital is equivalent to not more than 10% of the value of its own assets; and <p>(c) falls within either of the following descriptions—</p> <ul style="list-style-type: none">(i) it neither held immovable property in Hong Kong, nor held (whether directly or indirectly) share capital (however described) in one or more private companies with direct or indirect holding of immovable property in Hong Kong;(ii) it held such immovable property or share capital (or both), but the aggregate value of the holding of the property and capital is equivalent to not more than 10% of the value of its own assets.

Implications of the Proposal

The implications of the proposal are set out below –

Financial and Civil Service Implication

1. The proposal will have minimal financial and civil service implication because the profit tax exemption will only apply to a small number of offshore VC funds that are selected as partner funds under the Scheme. Implementation of the proposal will have no additional resource implication. Any additional administrative duties arising from the proposal will be absorbed by the Innovation and Technology Commission/Inland Revenue Department from within their existing resources.

Sustainability Implication

2. The proposal could help attract more offshore VC funds to invest in the local I&T ecosystem which should be conducive to the sustainable development of our economy.