

立法會
Legislative Council

LC Paper No. CB(1)1036/18-19
(These minutes have been seen
by the Administration)

Ref : CB1/BC/6/18

**Bills Committee on Inland Revenue (Profits Tax Exemption for Funds)
(Amendment) Bill 2018**

**Minutes of first meeting held on
Monday, 7 January 2019, at 2:30 pm
in Conference Room 3 of the Legislative Council Complex**

- Members present** : Hon Kenneth LEUNG (Chairman)
Hon James TO Kun-sun
Hon WONG Ting-kwong, GBS, JP
Hon Charles Peter MOK, JP
Hon Christopher CHEUNG Wah-fung, SBS, JP
Hon CHAN Chun-ying, JP
Hon CHEUNG Kwok-kwan, JP
- Member absent** : Hon CHUNG Kwok-pan
- Public Officers attending** : Agenda item II
Financial Services and the Treasury Bureau
Mr Chris SUN, JP
Deputy Secretary (Financial Services)1
Miss Carrie CHANG
Principal Assistant Secretary (Financial Services)1
Mr Winston CHAN
Assistant Secretary (Financial Services)(1)2

Inland Revenue Department

Mr CHIU Kwok-kit, JP
Deputy Commissioner (Technical)

Miss HUI Chiu-po
Senior Assessor (Research)1

Department of Justice

Ms Rayne CHAI
Senior Assistant Law Draftsman

Clerk in attendance : Mr Daniel SIN
Chief Council Secretary (1)6

Staff in attendance : Mr Alvin CHUI
Assistant Legal Adviser 3

Ms Mandy LI
Senior Council Secretary (1)6

Mr Patrick CHOI
Council Secretary (1)6

Miss Yolanda CHEUK
Legislative Assistant (1)6

Ms Yvonna HO
Clerical Assistant (1)6

Action

I. Election of Chairman

Election of Chairman

Mr James TO Kun-sun, the member who had the highest precedence in the Council among members of the Bills Committee on Inland Revenue (Profits Tax Exemption for Funds) (Amendment) Bill 2018 present at the meeting, presided over the election of Chairman of the Bills Committee. He invited nominations for the chairmanship of the Bills Committee.

2. Mr CHAN Chun-ying nominated Mr Kenneth LEUNG and the nomination was seconded by Mr WONG Ting-kwong. Mr Kenneth LEUNG accepted the nomination.

3. Mr James TO Kun-sun invited other nominations for the chairmanship. As there was no other nomination, Mr James TO Kun-sun declared that Mr Kenneth LEUNG was elected the Chairman of the Bills Committee. Mr Kenneth LEUNG then took over the chair.

Election of Deputy Chairman

4. Members agreed that there was no need to elect a Deputy Chairman.

II. Meeting with the Administration

(LC Paper No. CB(3)243/18-19 -- The Bill

File Ref.: ASST/3/1/5C (2018) Pt. 19 -- Legislative Council Brief

LC Paper No. LS30/18-19 -- Legal Service Division Report

LC Paper No. CB(1)414/18-19(01) -- Marked-up copy of the Bill prepared by the Legal Service Division (Restricted to members)

LC Paper No. CB(1)414/18-19(02) -- Background brief prepared by the Legislative Council Secretariat

LC Paper No. CB(1)414/18-19(03) -- Letter from Assistant Legal Adviser to the Administration dated 3 January 2019)

Discussion

5. The Bills Committee deliberated (index of proceedings in the **Appendix**).

6. The Bills Committee completed clause-by-clause examination of Inland Revenue (Profits Tax Exemption for Funds) (Amendment) Bill 2018 ("the Bill").

7. The Administration informed the Bills Committee that after the Bill is passed, the Inland Revenue Department would issue a set of Departmental Interpretation and Practice Notes which would cover the interpretation and practice relating to the Bill as a whole.

Invitation for views

8. The Bills Committee agreed that a public hearing session would not be held, but written submissions on the Bill would be invited from the public and relevant organizations.

(Post-meeting note: Invitations were issued on 8 January 2019 for written submissions on the Bill. By 14 January 2019, a total of 11 written submissions were received.)

Date of next meeting

9. The Chairman said that a meeting had been scheduled for 16 January 2019 to discuss or follow up on the written submissions, if necessary.

III. Any other business

10. There being no other business, the meeting ended at 3:54 pm.

Council Business Division 1
Legislative Council Secretariat
7 May 2019

**Bills Committee on Inland Revenue (Profits Tax Exemption for Funds)
(Amendment) Bill 2018**

**Proceedings of first meeting
on Monday, 7 January 2019, at 2:30 pm
in Conference Room 3 of the Legislative Council Complex**

Time marker	Speaker	Subject(s)	Action required
Agenda item I — Election of Chairman			
000352 – 000513	Mr James TO Mr CHAN Chun-ying Mr WONG Ting-kwong Mr Kenneth LEUNG	Election of Chairman	
Agenda item II — Meeting with the Administration			
000514 – 001131	Chairman Administration	Briefing by the Administration	
001132 – 001233	Chairman Mr WONG Ting-kwong	Mr WONG Ting-kwong supported the Bill.	
001234 – 002110	Chairman Mr CHAN Chun-ying	<p>Mr CHAN Chun-ying supported the Bill and he requested the Administration to explain the rationale behind the anti-tax evasion provisions of the Bill.</p> <p>The Administration explained that the immovable property test, holding period test and short-term asset test set out in the proposed sections 20AP and 20AQ aimed to reduce the risk of tax evasion by funds through their investments in private companies. The immovable property test was introduced to discourage funds from investing excessively in the local immovable property market. The holding period test and the short-term asset test were targeted at encouraging funds to focus on the longer-term prospects of the investee private companies. The short-term asset test also aimed to reduce the risk of tax abuse by engaging in trading activities (i.e. transacting in trading assets) through sales of shares in private companies.</p> <p>The Administration supplemented that the same thresholds of the immovable property test and the short-term asset test were adopted from the existing profits tax exemption regime for open-ended fund companies ("OFCs"). The two-year period under the holding period test was drawn up having regard</p>	

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		to the information gathered from the private equity ("PE") fund industry in the earlier industry consultation exercise. According to the industry statistics, around 85% of the investments made by PE funds were held for two years or more.	
002111 – 002539	Chairman Mr Charles MOK	<p>Mr Charles MOK expressed in-principle support to the Bill, and asked whether the Administration had assessed the potential impacts of the proposed profits tax exemption for funds on investment in local businesses. He also enquired whether annual data on fund industry's investment in local businesses would be available for the tracking and quantification of the impact of the Bill.</p> <p>The Administration responded that there were no statistics to support an assessment at this stage, but the proposed tax exemption measure should remove the tax disincentives for funds to invest in Hong Kong's private companies. The Administration might consider how best to assess the reception and impact of the Bill following its implementation.</p>	
002540 – 002805	Chairman Mr CHAN Chun-ying	<p>Mr CHAN Chun-ying queried where a fund had invested in such private companies with immovable property assets, at which point in time would the immovable property test be applied to determine the fund's eligibility for profits tax exemption under the Bill.</p> <p>The Administration explained that a snapshot of the private company's assets would be taken when the fund made a transaction in the private company concerned. The eligibility for tax exemption would then be assessed according to the proportion of the immovable property's value over the private company's assets.</p>	
002806 – 003130	Chairman Administration	<p>The Chairman enquired about the consultation exercise that had been conducted.</p> <p>The Administration responded that an industry consultation was conducted in April and May 2018 with relevant stakeholders, including the fund sector, major accounting firms and relevant professional bodies. No objections were received on the direction of the Bill, and the Administration had addressed the issues raised by the sector through an interactive process.</p>	

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		<p>The Administration supplemented that the sector's views had been carefully considered and incorporated where appropriate into the current Bill.</p> <p>Members agreed to invite written submissions on the Bill from the public and relevant organizations, and that a public hearing session would not be held.</p>	
003131 – 003623	Chairman Administration	<p>Clause-by-clause examination of the Bill (LC Paper No. CB(3)243/18-19)</p> <p><u>Clause 1 – Short title and commencement</u></p> <p><u>Clause 2 – Inland Revenue Ordinance amended</u></p> <p><u>Clause 3 – Section 20AB amended (interpretation of sections 20AC, 20ACA, 20AD, 20AE, 20AF, 20AG, 20AH, 20AI, 20AJ, 20AK and 20AL and Schedules 15, 15A, 15B, 16A and 16B)</u></p> <p>In response to the Chairman's enquiry, the Administration advised that the repealed sections under the amendment in section 20AB were related to OFCs.</p> <p>Upon the Chairman's request, the Administration agreed to consider in future whether the short title of the Bill should also indicate the number of times the principal ordinance had been amended in a year besides a brief description of the subject matter in the current amendment.</p>	
003624 – 003749	Chairman Administration	<p><u>Clause 4 – Section 20AC amended (certain profits of non-resident persons exempt from tax)</u></p> <p>The Chairman sought clarification on the meaning of "non-resident person" in the context of section 20AC of the Inland Revenue Ordinance (Cap. 112).</p> <p>The Administration explained that on and after 1 April 2019 (when the amended Ordinance would take effect), a reference to "non-resident person" in section 20AC would cover non-resident non-fund entities, which would mainly include non-resident individuals and non-resident enterprises without permanent establishment in Hong Kong, and non-resident enterprises and corporations which did not fall within the meaning of "fund" as defined in</p>	

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		the proposed section 20AM.	
003750 – 005029	Chairman Administration Assistant Legal Adviser ("ALA3")	<p><u>Clause 5 – Sections 20AG to 20AL repealed</u></p> <p><u>Clause 6 – Sections 20AM to 20AY added</u> <i>20AM. What fund means in sections 20AN, 20AO, 20AP, 20AQ, 20AR, 20AS, 20AT, 20AU, 20AV, 20AW, 20AX and 20AY and Schedules 15C, 15D and 16C</i></p> <p>The Chairman sought clarification on the meaning of "fund" in the proposed section 20AM.</p> <p>The Administration explained that the definition of "fund" as set out in the proposed section 20AM of the Bill was drawn up taking into consideration the definition of "collective investment scheme" in Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571), related provisions in Cap. 112 as well as the comments received from the industry during the consultation exercise. The proposed definition of "fund" in the proposed section 20AM should be wide enough to capture different kinds of bona fide funds in operation, regardless of their structure, their size or the purposes that they served.</p> <p>ALA3 queried whether a fund investing in a private company which engaged in one of the listed commercial activities in the proposed section 20AM(7) would be regarded as having "indirectly" engaged in those activities and would, as a consequence, not eligible for profits tax exemption under the Bill.</p> <p>The Administration explained that the Bill allowed a fund to invest in local or overseas private companies carrying on a trade or business. Although the fund might be seen as being "indirectly" engaging in certain trading or business activities, such investment activities were part of the normal operation of a fund and would not affect the fund's eligibility for profits tax exemption under the Bill.</p> <p>The Administration also considered that, to avoid a fund meeting the definition of "fund" under the proposed section 20AM and engaging in bona fide investment activities being regarded as a business undertaking for general commercial or industrial</p>	

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		<p>purposes, it would not be appropriate to add "indirectly" in the proposed section 20AM(7).</p>	
<p>005030 – 010154</p>	<p>Chairman Administration ALA3</p>	<p><i>20AN. Certain profits of certain funds exempt from payment of profits tax</i></p> <p>In response to the Chairman's enquiry, Administration clarified that a fund which did not engage a specified person to arrange or carry out its transactions would need to satisfy the condition of a "qualified investment fund" at all times during the year of assessment in order to qualify for the tax exemption under the Bill.</p> <p>In response to the Chairman's further query, the Administration explained that an OFC was eligible for profits tax exemption in respect of transactions in assets of a non-Schedule 16C class under the current section 20AH. OFCs were regulated by the Securities and Futures Commission ("SFC") and at least 90% of their investments were required to be securities or related products. The Administration considered that, as OFCs were already subject to stringent regulation of SFC, OFCs should continue to enjoy profits tax exemption on a wider range of transactions.</p> <p>ALA3 queried whether there were any overlapping between section 20AC and the proposed section 20AN in respect of tax exemption arrangements for offshore privately offered funds, and whether an offshore fund currently exempt from profits tax under section 20AC but could not meet the definition of "fund" under the proposed section 20AM could continue to enjoy profits tax exemption under the former provision on and after 1 April 2019.</p> <p>The Administration advised that after the Bill was passed, an arrangement meeting the definition of "fund" under the proposed section 20AM would be eligible for profits tax exemption under the proposed section 20AN for any year of assessment commencing on or after 1 April 2019. A non-resident entity which did not meet the definition of "fund" under the proposed section 20AM but could satisfy the exemption conditions under section 20AC could continue to enjoy tax exemption under that section. There should not be any overlapping between section 20AC and the</p>	

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		<p>proposed section 20AN.</p> <p>ALA3 queried the reason for removing the requirement in section 20AH(2)(b) that an OFC must be "non-closely held" in order for it to be eligible for profits tax exemption, without reinstating the "non-closely held" requirement elsewhere in the Bill.</p> <p>The Administration explained that the conditions for OFCs to be eligible for profits tax exemption should basically be the same as those for the other funds so that there would be a level playing field for funds operating in Hong Kong. All funds, including OFCs, were required to (a) engage a specified person to arrange or carry out its transactions in Hong Kong, or (b) be a qualified investment fund in order to enjoy profits tax exemption under the proposed section 20AN. These conditions would replace the "non-closely held" requirement in section 20AH.</p>	
010155 – 010304	Chairman Administration	<p><i>20AO. Certain profits of special purpose entities exempt from payment of profits tax</i></p> <p>In response to the Chairman's enquiry, the Administration confirmed that the special purpose entities must be positioned in between a fund and the investee private company.</p>	
010305 – 010755	Chairman Administration ALA3	<p><i>20AP. When does exemption under section 20AN or 20AO not apply to specified body holding immovable property through another company</i></p> <p><i>20AQ. When does exemption under section 20AN or 20AO not apply to specified body not holding immovable property through another company</i></p> <p>ALA3 sought the Administration's clarification on the meaning of "in good faith" in these proposed sections, and queried under what circumstances would the specified condition not be regarded as being met "in good faith".</p> <p>The Administration advised that the phrase "in good faith" was intended to guard against notional but not genuine compliance of the requirement. Similar wording could be found in other provisions of Cap. 112, such as section 26A(1A)(a)(ii)</p>	

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		<p>(relating to profits tax exemption for publicly offered funds) and section 14G(1) (relating to profits tax concessions to qualifying aircraft lessors and qualifying aircraft leasing managers). The Inland Revenue Department ("IRD") would examine the totality of facts in determining whether a fund or an SPE was acting in good faith.</p>	
010756 – 010858	Chairman Administration	<p><i>20AR. Supplementary provision to sections 20AP and 20AQ</i></p> <p>In response to the Chairman's enquiry, the Administration supplemented that the three tests under the proposed sections 20AP and 20AQ did not apply to a partner fund as the co-investment by the partner fund and the Innovation and Technology Venture Fund ("ITVF") Corporation was subject to the control and monitoring under the ITVF scheme. This was to retain the same tax treatment under the current tax regimes for the co-investment of partner funds.</p>	
010859 – 011140	Chairman Administration ALA3	<p><i>20AS. When does exemption under section 20AN not apply to open-ended fund companies</i></p> <p>ALA3 queried under what circumstances an OFC would be regarded as carrying on a direct trading or direct business undertaking in Hong Kong in assets of a non-Schedule 16C class, or holding such assets to generate income, and whether such circumstances should be set out in the Bill.</p> <p>The Administration advised that the profits of an OFC or of other funds arising from direct trading or direct business undertaking should be chargeable to profits tax. If an OFC engaged in direct trading or direct business undertaking in Hong Kong in assets of a non-Schedule 16C class, or utilizes such assets to generate income, such activities were still chargeable to profits tax. The Administration pointed out that the operations of each OFC were different, and it would be difficult to specify the types of assets of a non-Schedule 16C class OFCs would invest in, and how these assets would be used for direct trading or direct business undertaking. The Administration considered it not appropriate to set out such circumstances in the Bill. However, after the Bill is passed, IRD would issue a set of Departmental Interpretation and Practice Notes ("DIPN") which would cover the</p>	

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		interpretation and practice relating to the Bill as a whole.	
011141 – 011645	Chairman Administration	<p>20AT. <i>Sub-funds of open-ended fund companies</i></p> <p>20AU. <i>Losses sustained by funds (other than open-ended fund companies) and special purpose entities</i></p> <p>20AV. <i>Losses sustained by open-ended fund companies</i></p> <p>20AW. <i>Interpretation of sections 20AX and 20AY and Schedules 15C and 15D</i></p> <p>20AX. <i>Assessable profits of funds regarded as assessable profits of resident persons</i></p> <p>20AY. <i>Assessable profits of special purpose entities held by funds regarded as assessable profits of resident persons</i></p> <p>The Chairman asked which party would be responsible to make a declaration of the details of the ownership interest of a resident person in a fund upon which assessable profits could be determined.</p> <p>The Administration clarified that the resident person would be responsible to make a declaration in a tax return if he held not less than 30% of beneficial interests in a fund.</p>	
011646 – 012430	Chairman Administration ALA3	<p><u>Clause 7 – Schedule 15B repealed (provisions for ascertaining amount of assessable profits of resident person under section 20AK)</u></p> <p><u>Clause 8 – Schedules 15C and 15D added</u> <i>Schedule 15C Provisions for Ascertain Amount of Assessable Profits of Resident Person under Section 20AX</i> <i>Schedule 15D Provisions for Ascertain Amount of Assessable Profits of Resident Person under Section 20AY</i></p> <p><u>Clause 9 – Schedule 16 amended (specified transactions)</u></p> <p><u>Clause 10 – Schedules 16A and 16B repealed</u></p> <p><u>Clause 11 – Schedule 16C added</u> <i>Schedule 16C Classes of Assets Specified for Transactions for Purposes of Section 20AN</i></p> <p><u>Clause 12 – Schedule 17A amended (specified</u></p>	

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		<p><u>alternative bond scheme and its tax treatment)</u></p> <p>The Chairman queried whether "certificates of deposit" as listed in Part 1 of the proposed Schedule 16C were restricted to those issued by banks and would not include debts, long term bonds or loan securities issued by financial institutions or corporations, which were sometimes also distributed as "certificates of deposit".</p> <p>The Administration responded that the term "certificates of deposit" mentioned in the proposed Schedule 16C was defined by Part 1 of Schedule 1 to Cap. 571 and would cover a wider range of products than those issued by banks. However, the Administration supplemented that financing products were subject to other regulations and were unlikely to be covered under the proposed Schedule 16C.</p> <p>In response to the Chairman's and ALA3's enquiries, the Administration advised that the two existing DIPNs would be amended to make it clear that section 20AC would not be applicable to funds within the meaning of section 20AM on and after 1 April 2019. The Administration supplemented that new DIPNs were now under preparation and might seek views from the relevant stakeholders during the process, if necessary.</p>	
Agenda item III — Any other business			
012431 – 012735	Chairman ALA3	Legislative timetable and concluding remarks	