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來函檔號 YOUR REF.: LS/B/8/18-19

7 January 2019

Mr Alvin CHUI  
Assistant Legal Adviser  
Legislative Council Complex  
1 Legislative Council Road  
Central  
Hong Kong

Dear Mr Chui,

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

I refer to your letter of 3 January seeking clarifications in relation to the captioned Bill ("the Bill"). I am writing to provide further information as requested.

**Clause 6 – proposed section 20AM** (in relation to definition of "fund")

The proposed sections 20AM(6) and (7) and the use of the word "directly" in the proposed section 20AM(7) are to put it beyond doubt that

a fund itself should not be directly undertaking any trading or business activities for general commercial or industrial purposes. Such activities/businesses include but are not limited to those as set out under the proposed section 20AM(7). Hence, the use of the word “includes”.

The above notwithstanding, a fund may invest in a private company<sup>1</sup>. Such a private company may carry on a trade or business. The fund may then be considered as “indirectly” engaging in certain trading or business activities. To avoid a fund meeting the definition under the proposed section 20AM and engaging in bona fide investment activities being regarded as a business undertaking, it would not be appropriate to add “indirectly” in the proposed section 20AM(7).

Clause 6 – proposed section 20AN (in relation to certain profits of certain funds exempt from payment of profits tax)

After the Bill is passed, an entity 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 does not meet the definition of “fund” under the proposed section 20AM but can meet the exemption conditions under section 20AC continues to enjoy tax exemption under that section. There should not be any overlapping between section 20AC and the proposed section 20AN.

Clause 6 – proposed section 20AN (regarding open-ended fund companies)

To ensure that there is a level playing field for funds operating in Hong Kong, we propose that the conditions for open-ended fund companies (“OFCs”) to be eligible for profits tax exemption should basically be the

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<sup>1</sup> For example, the main investment of a private equity fund would be in private companies. According to the proposed section 20AN and Schedule 16C, investment in private companies falls under the list of qualifying transactions of a fund.



same as those for the other funds. We propose that all funds, including OFCs, are required to (a) engage a specified person (i.e. a licensed corporation of the Securities and Futures Commission) to arrange or carry out its transactions in Hong Kong, or (b) be a “qualified investment fund” (generally with at least five investors and meeting certain requirements over capital commitments and distribution of the net proceeds) in order to enjoy profits tax exemption under the proposed section 20AN. The non-closely-held condition for OFCs will be replaced by the aforementioned requirement.

Clause 6 – proposed sections 20AP and 20AQ (in relation to the meaning of “in good faith”)

The words “in good faith” are intended to guard against notional but not genuine compliance of the requirement. Similar wording (i.e. the Latin equivalent “bona fide”) can be found in the Inland Revenue Ordinance, such as section 26A(1A)(a)(ii) (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).

Clause 6 – proposed section 20AS (in relation to circumstances where profits tax exemption does not apply to OFCs)

As a principle, the profits of an OFC (or of other funds) arising from direct trading or direct business undertaking should be chargeable to profits tax. The tax treatment under the proposed section 20AS is the same as set out in the current section 20AH(7). Hence, despite that an OFC may enjoy profits tax exemption on transactions in non-qualifying assets pursuant to the proposed section 20AN, if an OFC engages in direct trading or direct business undertaking in Hong Kong in non-qualifying assets, or utilises non-qualifying assets to generate income, the aforementioned activities are still chargeable to profits tax.

Since the operation of each OFC differs, it would be difficult to specify the types of non-qualifying assets which OFCs would invest in, and how these assets would be used for direct trading or direct business undertaking. Therefore, we consider it not appropriate to set out such circumstances in the Bill.

Yours sincerely,



( Winston CHAN )

for Secretary for Financial Services and the Treasury

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