



14 January 2019

Clerk to Bills Committee on Inland Revenue (Profits Tax Exemption for Funds)
(Amendment) Bill 2018
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Dear Sir,

Re: Bills Committee on Inland Revenue (Profits Tax Exemption for Funds)
(Amendment) Bill 2018: Invitation for submissions [265621(FID1519510)]

- A. The Hong Kong Trustees' Association closely follow the development of Hong Kong tax law affecting the tax treatment of trustees and their income. We welcome the opportunity to make our submission to the Bills Committee on the Inland Revenue (Profits Tax Exemption for Funds (Amendment) Bill 2018 (the "Bill").
- B. We acknowledge that the removal of the ring-fencing provisions in the offshore funds profits tax exemption regime is necessary to address the concern that Hong Kong's tax regimes are considered harmful by EU in providing profits tax exemption to offshore, but not onshore, funds and only allows offshore funds to have profits tax exemption with investment in private companies incorporated overseas but not locally.
- C. We are encouraged by the Government's assessment that the envisaged changes will bolster the professional and the asset and wealth management industries in Hong Kong. We also welcome a change that will put funds structured as Hong Kong trusts and Hong Kong companies on equal footing with non-resident trusts and companies; and believe the change can reverse the preference that hereto existed against the use of Hong Kong trustees and entities.

- D. That being said, we wish to ensure that private trusts and investment funds of family offices are well within the scope of the definition of “funds” in section 20AM of the Bill, and able to enjoy the profits tax exemption where they meet the other qualifying criteria (in section 20 AN).
- E. Historically it was the case that *non-resident* family trusts and investment funds of family offices and other private wealth management entities investing in qualifying investments managed by or arranged by specified persons were able to avail themselves of the current profits tax exemption regime in section 20AC. Such entities appointed Hong Kong licensed fund managers to effect transactions specifically exempted from profits tax in Schedule 16. Because of the operation of the section 20AC exemption, such entities had legal certainty that all of the profits generated by them or on their behalf in Hong Kong from specified transactions, and transactions incidental thereto, would be exempt from profits tax, without necessitating a line by line analysis of the source of each investment income or fact based analysis of whether the fund management activities amounted to carrying on of business in Hong Kong.
- F. The existing section 20AC regime was drafted in terms such that it exempted non-resident persons generally with respect to profits arising in Hong Kong from specified transactions carried on in Hong Kong through Hong Kong intermediaries. The legislative requirement for eligibility under the old regime was to be a ‘non-resident’. The IRO set out explicit provisions of when a trustee of a trust estate is considered a ‘non-resident’.
- G. The envisaged changes in the Bill will shift the requirement to the exempted taxpayer being a ‘fund’, with the intention that funds of different types and sizes can qualify, regardless of where the Fund is centrally managed and control.
- H. Albeit we would expect in practice certain private trusts and family office investment functions to qualify as funds after the amendment of the funds taxation regime, we have identified the following definitional issues for your consideration:
1. *Section 20AM(2): Define Fund in section 20AM with reference to Trust structures*
 - 1.1. Nowhere in the draft section 20AM does the definition of fund explicitly refer to trustee of the trust estate¹. It is ambiguous whether a fund structured as a trust is within the ambit of the exemption. In contrast, the draft Bill explicitly refers to where the SPE held by the fund is a trust, and also refers to associate/ beneficial interest in the fund held through a trust. We believe the intention of section 20AM(2) is to include:
 - A trust as an ‘arrangement’,

¹ Trustee being the taxable person in relation to income of a trust under the Inland Revenue Ordinance.

- A trustee of a trust as a ‘person operating an arrangement’, and
- A settlor/ asset contributor to the trust as a ‘participating persons’.

1.2. If our understanding is correct, it would be most helpful to the trust industry if these aspects to the definition of ‘fund’, as applied to a trust arrangement, were set out in section 20AM.

1.3. As noted in the background in paragraph E above, hereto the exemption was available to non-resident trustees of trust estates and not to resident trustees. This meant the industry has been developed with a preference for a non-Hong Kong trustee over a Hong Kong trustee. The Bill is welcomed by the trust industry to level the playing field by making the use of Hong Kong trustee as a viable option on equal footing. It would be detrimental if section 20AM does not include funds structured as trust; with the non-resident trusts continued to be exempted under section 20 AC while the Hong Kong trusts cannot avail themselves to section 20AN.

2. *Section 20AC(2)(b): Day-to-day control of investment by the Settlor of a trust*

2.1. Pursuant to section 20AC(2)(b) of the Bill, participants in a fund cannot exercise day-to-day control over the management of the property – this may in practice exclude from the definition of a fund private trusts where the settlor exercises reserved rights on the terms of the trust instrument to appoint the investment manager or to manage the investment of the trust fund. Reserved powers of investment and asset management is widely popular in private trust arrangements, and explicitly recognized in the Trustee Ordinance (Cap 29) as amended in 2013 (see section 41X).

2.2. We propose for section 20AC(2)(b) of the Bill to be rephrased to state that participants cannot exercise day to day control over the management of the Fund (i.e. the Trust) rather than the property (i.e. the investments). We note the other qualifying requirement already in place for the investments to be managed or arranged by an SFC licensed intermediary.

3. *Section 20AM(5)(a): Is a Private Trust Company arrangement an arrangement otherwise than by way of business*

3.1. As it is proposed that a fund excludes an arrangement operated by a person otherwise than by way of business, this would exclude a

private trust with a non-professional trustee. We also query whether trusts administered by Private Trust Companies (PTC) would fall outside the definition of funds.

- 3.2. It is not uncommon for families of substantial wealth to set up PTCs; in such cases, the trustees of the trusts will be family owned and/or managed companies, instead of a third party professional trustee. A PTC set up overseas can presently qualify for exemption under section 20AC (so long as it is not ultimately owned more than 30% by Hong Kong residents). It would be helpful if they continue to be exempted, along with PTCs set up as Hong Kong companies, under the new sections 20AM/20AN.

4. *Section 20AM(6): business undertaking of a family office*

- 4.1. The exclusion of business undertakings for general commercial or industrial purposes, such purposes including, among other things, property development and property holding, money-lending, and the making of direct investments that derive rent, royalties or lease payments, could, if the notion of “business undertaking” were construed broadly, operate to exclude trustees of private trusts and family office investment entities that have diversified property portfolios in such areas or industries, where the operation of the fund (the trust) is but one aspect of the business of the trustee or the family office. It may be considered for the Bill to clarify that the operator of the fund (i.e. the trustee) may have such business undertaking but the Fund (i.e. the trust) shall not.

We thank you again for the opportunity to put forward our submission. We would be happy to discuss further or address any follow up questions the Bills Committee may have.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Jacqueline Shek', with a stylized flourish at the end.

Jacqueline Shek
Chairman
HK Trustees' Association