立法會
Legislative Council

LC Paper No. CB(1)552/18-19
(These minutes have been seen by the Administration)

Ref : CB1/PL/FA

Panel on Financial Affairs

Minutes of meeting held on
Monday, 5 November 2018, at 9:30 am
in Conference Room 1 of the Legislative Council Complex

Members present : Hon Christopher CHEUNG Wah-fung, SBS, JP (Chairman)
Hon Kenneth LEUNG (Deputy Chairman)
Hon James TO Kun-sun
Hon Abraham SHEK Lai-him, GBS, JP
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon WONG Ting-kwong, GBS, JP
Hon Starry LEE Wai-king, SBS, JP
Hon CHAN Kin-por, GBS, JP
Hon Mrs Regina IP LAU Suk-yee, GBS, JP
Hon Steven HO Chun-yin, BBS
Hon WU Chi-wai, MH
Hon Charles Peter MOK, JP
Hon Martin LIAO Cheung-kong, SBS, JP
Ir Dr Hon LO Wai-kwok, SBS, MH, JP
Hon Alvin YEUNG
Hon CHU Hoi-dick
Hon Holden CHOW Ho-ding
Hon SHIU Ka-fai
Hon CHAN Chun-ying, JP
Hon CHEUNG Kwok-kwan, JP
Hon LUK Chung-hung, JP
Hon Kenneth LAU Ip-keung, BBS, MH, JP

Member attending : Dr Hon KWOK Ka-ki

Members absent : Hon Dennis KWOK Wing-hang
Hon HO Kai-ming

Public officers attending : Agenda Item IV

Mr Norman T.L. CHAN, GBS, JP
Chief Executive
Hong Kong Monetary Authority

Mr Eddie YUE, JP
Deputy Chief Executive
Hong Kong Monetary Authority

Mr Arthur YUEN, JP
Deputy Chief Executive
Hong Kong Monetary Authority

Mr Howard LEE, JP
Deputy Chief Executive
Hong Kong Monetary Authority

Agenda Item V

Mr Chris SUN, JP
Deputy Secretary for Financial Services and the Treasury (Financial Services)1

Miss Carrie CHANG
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)1

Mr Winston CHAN
Assistant Secretary for Financial Services and the Treasury (Financial Services)(1)2

Mr CHIU Kwok Kit, JP
Deputy Commissioner (Technical)
Inland Revenue Department

Miss HUI Chiu Po
Senior Assessor (Research)1
Inland Revenue Department

Clerk in attendance : Ms Connie SZETO
Chief Council Secretary (1)4

Staff in attendance : Miss Sharon LO
Senior Council Secretary (1)9

Ms Sharon CHAN
Legislative Assistant (1)4

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I Confirmation of minutes of meeting and matters arising

(LC Paper No. CB(1)103/18-19 — Minutes of the meeting on 11 October 2018)

The minutes of the meeting held on 11 October 2018 were confirmed.

II Information papers issued since the regular meeting on 3 July 2018

(LC Paper No. CB(1)1328/17-18(01) — Second Quarter Economic Report 2018 and the press release

LC Paper No. CB(1)1335/17-18(01) — The Quarterly Report of the Securities and Futures Commission (April to June 2018)

LC Paper No. CB(1)1408/17-18(01) — Second quarterly report of 2018 on "Employees Compensation Insurance □ Reinsurance Coverage for Terrorism"

LC Paper No. CB(1)1406/17-18(01) — Administration's paper on "Enhancements to the Stock Exchange of Hong Kong Limited's Decision-making and Governance Structure for Listing Regulation"

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LC Paper No. CB(1)1406/17-18(02) — Administration's paper on "Review of the Growth Enterprise Market ("GEM") and Changes to the GEM and Main Board Listing Rules"

LC Paper No. CB(1)1412/17-18(01) — Letter dated 10 September 2018 from Hon Dennis KWOK and Hon Alvin YEUNG on issues relating to the investment strategy of the Hong Kong Monetary Authority (Chinese version only)

LC Paper No. CB(1)1412/17-18(02) — Letter dated 13 September 2018 from Hon James TO on issues relating to the investment strategy of the Hong Kong Monetary Authority (Chinese version only)

LC Paper No. CB(1)127/18-19(01) — Administration's paper on "Phase 2 clearing under the over-the-counter derivatives regulatory regime in Hong Kong")

2. Members noted the information papers issued since the regular meeting held on 3 July 2018.

III Date of next meeting and items for discussion

(LC Paper No. CB(1)101/18-19(01) — List of outstanding items for discussion)

3. The Chairman said that members were informed earlier that the regular meeting for December 2018 would be re-scheduled to Tuesday, 18 December 2018. Members agreed to discuss the following items proposed by the Administration at the meeting:

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(a) Briefing by the Financial Secretary on Hong Kong's latest overall economic situation;

(b) 2019-2020 Budget consultation;

(c) Funding requirements for a centralized electronic platform for the administration of Mandatory Provident Fund registered schemes;

(d) Charging Mandatory Provident Fund approved trustees the Annual Registration Fee;

(e) Possible modifications to the rates concession mechanism; and

(f) Proposed revision of fees and charges for services under the Customs and Excise Department.

4. Members further agreed that the meeting on 18 December 2018 would be held from 2:30 pm to 6:30 pm to allow sufficient time for discussion of the above six items.

IV Briefing on the work of Hong Kong Monetary Authority

(LC Paper No. CB(1)101/18-19(02)	—	Paper provided by the Hong Kong Monetary Authority
LC Paper No. CB(1)101/18-19(03)	—	Letter dated 25 October 2018 from Hon CHEUNG Kwok-kwan on issues relating to the security of the Faster Payment System (Chinese version only))

Briefing by the Hong Kong Monetary Authority

5. At the invitation of the Chairman, the Chief Executive, Hong Kong Monetary Authority ("CE/HKMA"), the Deputy Chief Executive (Banking), Hong Kong Monetary Authority ("DCE(B)/HKMA"), the Deputy Chief Executive (Monetary), Hong Kong Monetary Authority ("DCE(M)/HKMA") and the Deputy Chief Executive (Development), Hong Kong Monetary Authority ("DCE(D)/HKMA") updated members on the work of HKMA through a powerpoint presentation. Topics included assessment of risks to Hong Kong's

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financial stability, banking supervision, financial infrastructure, development of the financial market, and investment performance of the Exchange Fund ("EF").

(*Post-meeting note*: The powerpoint presentation materials (LC Paper No. CB(1)137/18-19(01)) were issued to Members vide Lotus Notes e-mail on 5 November 2018.)

Discussion

Macroeconomic conditions and the impacts of interest rate normalization

6. Dr KWOK Ka-ki and Mr Jeffrey LAM expressed concerns about the impacts of the lingering trade conflict between China and the United States ("US") on Hong Kong. Pointing out that economic growth in the Mainland in recent years was increasingly supported by internal consumer demand, Mr CHAN Kin-por enquired whether such a development would help the Mainland cope with the challenges brought by the China-US trade conflict.

7. CE/HKMA remarked that there would be no winner in a trade war. The US' trade protectionist measures against China could lead to higher prices of imported goods and hence increased inflationary pressure in the US. CE/HKMA added that the Mainland economy had been undergoing a structural change by gradually shifting from export-led to consumption-led. The change would make the economic growth of the Mainland more sustainable and would be conducive to a more balanced trade relationship between the Mainland and the US.

8. Noting that the fund outflow in 2018 accounted for around one-tenth of the capital inflow into Hong Kong since 2008, Mr CHAN Kin-por sought HKMA's assessment on the pace of local interest rate development and asked what advice it had for the public.

9. CE/HKMA said that under the design of the Linked Exchange Rate System ("LERS"), capital outflow would lead to an increase in the Hong Kong dollar ("HKD") interest rates. In case the capital outflow continued, HKD interest rates could rise above their US dollar ("USD") counterparts, thereby incentivising capital inflow into HKD again. This was how the automatic interest rate adjustment mechanism worked.

Development of financial technologies and cross-border payment

10. Mr CHAN Chun-ying referred to the e-wallet top-up incident happened in October 2018 which might have involved the theft of personal information for setting up e-wallet accounts and making direct debit authorization for account

top-up. He enquired about HKMA's follow-up measures in enhancing banks' electronic direct debit authorization ("eDDA") procedure, and if HKMA would consider imposing requirements on: (a) the collection and use of personal data; and (b) authentication of eDDA for both physical banks and virtual banks.

11. Mr CHEUNG Kwok-kwan expressed concern about why HKMA was unable to identify the loopholes of e-wallet and eDDA procedure, and why HKMA only disclosed the incident some two weeks after it became aware of the fraud cases. As HKMA played a vital role in regulating the operation of stored value facility operators, Mr CHEUNG stressed the importance for HKMA to stay vigilant in enhancing the security of e-wallets to prevent recurrence of similar incidents.

12. Mr Charles Peter MOK urged HKMA to learn lessons from the e-wallet top-up incident, and stressed the need for HKMA to step up risk assessment measures prior to the launch of other new financial technologies initiatives, including the Open Application Programming Interface and virtual banking. He also cautioned about potential loopholes in HKMA's enhanced security measures for e-wallets and eDDA. Pointing out that introduction of electronic know-your-client ("eKYC") could strengthen the security of eDDA, Mr MOK enquired about the implementation timetable of eKYC.

13. CE/HKMA said that there was a need to strike a reasonable balance between convenience and security. HKMA welcomed Members' views and suggestions. Regarding the e-wallet top-up incident, CE/HKMA and DCE(D)/HKMA pointed out that it was not related to the security of the Faster Payment System itself, but had arisen from a novel practice of fraudsters. HKMA had conducted a thorough review of the incident and strengthened the procedures for setting up eDDA. It was believed that the enhanced security measures could prevent similar incidents in the future. DCE(D)/HKMA added that as banks had to rely on third parties to conduct authentication, particular attention had to be paid to this area going forward. CE/HKMA added that banks (including virtual banks) needed to comply with know-your-customer requirements (which involved ascertaining the authenticity of individual customers, and understanding the background of the customers), and HKMA adopted a risk-based approach in supervising regulatees' compliance with such requirements. On the implementation of eKYC, DCE(B)/HKMA remarked that HKMA was liaising with the industry on the matter, and the Hong Kong Association of Banks was taking a lead in its implementation.

14. Mr LUK Chung-hung enquired about the progress of various proposed measures to facilitate cross-border payments between Hong Kong and the Mainland, including connecting Hong Kong e-wallets with the Mainland's

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payment system and helping Hong Kong residents to open Mainland e-wallets. Mr Charles Peter MOK cautioned that HKMA should carefully tackle the risks arising from the use of Hong Kong e-wallets in the Mainland, including ensuring that sufficient measures on consumer protection and safeguarding personal data were in place.

15. CE/HKMA advised that some Hong Kong e-wallets had launched pilot schemes for cross-border payments in the Mainland. HKMA had also been exploring with the relevant Mainland authorities on measures to simplify the process for Hong Kong residents to open bank accounts in the Mainland, such as standardizing the requirements, and waiving the need for Hong Kong residents to provide Mainland telephone numbers and residential addresses.

The property market

16. Mr Jeffrey LAM pointed out that the protracted China-US trade conflict had led to changes in global procurement patterns, and some companies might consider relocating their operations in the Mainland back to Hong Kong. However, such companies faced difficulties in obtaining loans from local banks for carrying out the relocation. In view of the recent changes in macroeconomic environment and the property market, Mr LAM asked whether HKMA would consider adjusting some of its countercyclical macroprudential measures to alleviate the difficulties encountered by such companies. For instance, increasing the ceiling of loan-to-value ("LTV") ratio for mortgage loans of industrial and commercial premises. He also enquired if HKMA had assessed the impacts of such adjustment measures on Hong Kong's financial stability.

17. DCE(B)/HKMA stressed that the countercyclical macroprudential measures were implemented in response to market cycles. HKMA was closely monitoring the data collected and the latest market developments. CE/HKMA added that it would take more time to observe the property market. If it could be ascertained that the market had entered a downward cycle, HKMA would consider whether some of the countercyclical macroprudential measures could be relaxed as appropriate.

18. Mrs Regina IP was concerned that, notwithstanding HKMA's assessment that the performance of the Hong Kong economy remained robust, if the China-US trade conflict persisted, the local unemployment rate might rise and the level of household income could drop, thus leading to a surge in the number of negative equities. She sought HKMA's views and advice for the public in this regard. Mrs IP also enquired whether HKMA had assessed the risks arising from the high LTV ratio mortgages offered by property developers through finance companies. Mr WU Chi-wai was concerned that HKMA might have overlooked

the risks brought by such high LTV ratio mortgages, and urged HKMA to step up its efforts in collecting relevant data for making more accurate assessments of the risks.

19. CE/HKMA pointed out that as a result of the eight rounds of countercyclical macroprudential measures for property mortgage loans since 2009, Hong Kong was now better prepared for a downward cycle in the property market as compared to the time of previous crises including the Asian Financial Crisis ("AFC"). For instance, there were currently fewer mortgages with 90% LTV ratio than before AFC. A mechanism had also been established for banks to find out whether a mortgage loan applicant had taken out any mortgage loans from other banks. The debt servicing ratio of newly approved mortgages in the second quarter of 2018 stood at 34% only, which could provide a strong buffer against worsening economic conditions in Hong Kong. Having said that, the public should manage risks prudently and be prepared for market volatilities.

20. On the risks arising from the high LTV ratio mortgages offered by property developers through finance companies, CE/HKMA and DCE(B)/HKMA noted that the number of such mortgages was on the low side. Based on HKMA's estimates, the aggregate amount of residential mortgage loans offered by property developers represented only about 2-2.5% of the total mortgage loans offered by banks. HKMA would continue to collect relevant data from banks and the Land Registry, and closely monitor latest market developments. DCE(B)/HKMA added that HKMA required banks to take all mortgages and other liabilities of borrowers into account in assessing the debt servicing ratio of newly approved mortgages. Furthermore, while HKMA was not the frontline regulator of property developers, HKMA had introduced in May 2017 measures to strengthen the risk management of banks on lending to property developers.

Investment strategy of the Exchange Fund

21. Mr Alvin YEUNG noted that the Financial Secretary had recently stated in his blog that "With the support of the State-owned Assets Supervision and Administration Commission of the State Council, the HKMA is now in discussions with some Central State-owned Enterprises to explore opportunities for cooperation and joint investment in overseas projects with stable return, in the form of equity investment." Pointing out the risky nature of Belt and Road Initiative ("BRI") projects, in particular some countries along the Belt and Road might consider postponing or even halting certain BRI projects, Mr YEUNG was concerned how HKMA would maintain its independence in deciding EF's investment in BRI projects, and that HKMA might be subject to political

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influence in making its investment decisions. He further called on HKMA to disclose details of EF's investment in infrastructure projects.

22. Mr Martin LIAO sought details of infrastructure projects that HKMA considered unsuitable for EF investment after its internal assessment. Pointing out that some BRI projects had been postponed or suspended recently, he enquired how HKMA would assess and mitigate the risks concerned.

23. CE/HKMA and DCE(M)/HKMA said that EF started investing in infrastructure projects under the Long-term Growth Portfolio ("LTGP") in recent years with the aim to further diversify EF's assets. The total amount of LTGP's infrastructure investments (including commitments) stood at some US$2.2 billion currently. They stressed that when considering whether to invest in individual infrastructure projects, HKMA would carefully assess the commercial and financial viability of the projects and implement appropriate risk-mitigating measures. HKMA would perform stress testing, conduct rigorous due diligence, and only work with experienced partners with good integrity and governance standards. They further pointed out that HKMA in general invested in infrastructure projects in two ways: (a) investing in a discretionary commingled fund managed by an international fund manager, or (b) investing or co-investing directly in an infrastructure project (such as EF's investments in two green energy projects in Northern Europe and South America respectively). Moreover, HKMA usually invested in brownfield projects (i.e. projects already under operation) because this would mitigate construction risk, one of the key risks associated with infrastructure projects. CE/HKMA and DCE(M)/HKMA stressed that HKMA would make its investment decisions independently and adopt the same assessment criteria for all projects, no matter they were located along the Belt and Road or not.

24. Regarding projects that were rejected by HKMA, DCE(M)/HKMA indicated that HKMA was not in a position to disclose specific details given commercial sensitivities. In general, HKMA would not invest in projects that could not offer attractive risk-adjusted returns or meet HKMA's stringent environmental, social, and governance standards. CE/HKMA stressed that, when making investment decisions on infrastructure projects, HKMA would not merely focus on the investment returns, but would also assess the risks carefully.

25. Mr CHAN Chun-ying noted that while infrastructure investment could generate relatively stable cash flow with low loss ratios, it only accounted for a small proportion of EF's LTGP. He enquired whether HKMA would consider expanding EF's allocation to infrastructure, and specifying a ratio of such investment in various regions/countries.

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26. CE/HKMA advised that it would not be appropriate to specify ratios for EF's infrastructure investment in various regions/countries, as whether an investment would be made would depend on the commercial and financial viability of individual projects. Both developed and emerging markets would be considered as appropriate.

Operation of the Linked Exchange Rate System

27. Dr KWOK Ka-ki and Mr James TO said that some members of the public had expressed concern about the role and stability of HKD arising from the recent remark made by Mr Joseph YAM, the former CE of HKMA and an incumbent Member of the Executive Council, that in the long run, renminbi ("RMB") instead of HKD should be used for transactions conducted in Hong Kong. In particular concern was raised about whether a substantial proportion of EF (which was currently predominantly denominated in USD) would eventually be converted into RMB, which would undermine the credibility of LERS. Dr KWOK and Mr TO urged HKMA to allay the public's concern by enhancing the disclosure of relevant information including the currency composition of EF and the amount of RMB-denominated assets or investments held or made by EF. Mr TO also enquired about the impacts of the currency swap agreement between Hong Kong and the Mainland on LERS.

28. On the remark made by Mr Joseph YAM, CE/HKMA said as he understood it, the remark did not suggest replacing HKD by RMB. The remark was more about the use of RMB instead of HKD by international investors for the settlement of financial transactions conducted in Hong Kong. Nonetheless, the currency to be used by international investors for settlement was to be determined by the market (e.g. stocks currently listed in Hong Kong might offer both HKD and RMB counters).

29. As for whether a substantial proportion of EF would be converted into RMB, CE/HKMA said that such a scenario would not happen under LERS, nor would EF be used to defend the exchange rate of RMB. He explained that offshore RMB could be exchanged freely for other currencies in Hong Kong, and such transactions were driven and carried out by market participants. The offshore RMB pool in Hong Kong stood at some RMB 600 billion in 2018, which was small in comparison with Hong Kong's Monetary Base (which amounted to about HK$1,600 billion). CE/HKMA reiterated that HKMA would carefully manage the some US$130 billion worth of capital inflows into Hong Kong since 2008 in order to meet capital outflows in the future. Regarding the currency swap agreement between HKMA and the People's Bank of China, CE/HKMA explained that it served to provide short-term RMB liquidity to the offshore RMB markets in Hong Kong as necessary. On the currency mix of EF's assets,

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CE/HKMA said that over 90% of the assets were denominated in USD and HKD, while the remaining assets were denominated in other currencies like Japanese Yen, Euro, Pound Sterling and RMB. HKMA disclosed the currency composition of EF on a regular basis.

Schemes administered by the Hong Kong Mortgage Corporation

30. Noting that the cap of the Life Annuity Scheme ("LAS") launched by the Hong Kong Mortgage Corporation ("HKMC") had not been reached, Mr LUK Chung-hung enquired whether HKMC would consider enhancing the flexibility of LAS in the future, such as providing the options for incremental monthly annuity payments and deferred annuities, as well as lowering the eligible age for application.

31. CE/HKMA advised that HKMC was processing the subscriptions of LAS. Given that LAS was a relatively new financial product, it would take time for the public to understand and accept it. HKMC would consider various suggestions on enhancing the flexibility of LAS.

32. Mr CHAN Chun-ying noted that the deadline for the SME Financing Guarantee Scheme had been extended to 30 June 2019. He asked whether HKMA would consider extending the deadline further if the number of applications was on the rise. CE/HKMA advised that HKMC was only responsible for the administration of the Scheme. Extension of the Scheme was to be decided by the Administration.

Regulation of cryptocurrencies

33. Mr Kenneth LEUNG noted that the Securities and Futures Commission ("SFC") had issued a paper regarding its new regulatory approach for virtual assets on 1 November 2018 including its plan to impose licensing conditions on managers and distributors of virtual assets. He enquired about the demarcation of responsibilities between HKMA and SFC in the regulation of cryptocurrencies which was regarded as virtual assets, and whether HKMA had formulated its own regulatory policy for cryptocurrencies. Referring to some media reports that Singapore might issue government-backed digital currencies, Mr LEUNG enquired about the progress of developing central bank digital currency ("CBDC") in Hong Kong.

34. CE/HKMA pointed out that crypto-assets could not qualify as "currencies". On HKMA's regulatory approach to crypto-assets, CE/HKMA and DCE(B)/HKMA advised that HKMA issued a circular in 2014 to banks advising them to be mindful of the need to comply with anti-money laundering and

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counter-terrorist financing ("AML/CTF") requirements in their dealings with crypto-assets, particularly given that such crypto-assets were transacted or held on the basis of anonymity. HKMA's position on the matter remained unchanged, and had reminded banks of the circular in 2017. As for the demarcation of responsibilities between HKMA and SFC, DCE(B)/HKMA advised that as far as crypto-assets were concerned, SFC focused on investor protection, while HKMA dealt with matters relating to AML/CTF controls of banks. The two regulators exchanged views on the regulation of crypto-assets regularly. Regarding the development of CBDC, CE/HKMA and DCE(D)/HKMA pointed out that a number of central banks had been studying the matter, including the pros and cons of issuing CBDC. Given CBDC's possible impact on financial stability, HKMA would need to carefully examine its viability and application.

V Proposed profits tax exemption for funds

(LC Paper No. CB(1)101/18-19(04) — Administration's paper on "Proposed profits tax exemption for funds")

Briefing by the Administration

35. At the invitation of the Chairman, Deputy Secretary for Financial Services and the Treasury (Financial Services)1 ("DS(FS)1") briefed members on the legislative proposal to amend the Inland Revenue Ordinance (Cap. 112) ("IRO") to provide profits tax exemption for funds operating in Hong Kong, regardless of the structure under which they were established or their location of central management and control. He said that the proposal sought to (a) remove ring-fencing tax features of the existing tax regimes for offshore funds in order to address the concern of the Council of the European Union ("EU"); and (b) further consolidate Hong Kong's competitive edge in the manufacturing and management of funds. He explained that under the legislative proposal, an entity meeting the definition of "fund" and fulfilled the specified person requirement or had a "qualifying fund" status could enjoy profits tax exemption on profits generated from specified transactions. To reduce the risk of tax leakage, a fund would be taxed on its profits from the transactions in securities of private companies that did not meet the tests on immovable property, holding period and holding of short-term assets. Moreover, funds remained subject to the current anti-round tripping provisions. The Administration planned to introduce the relevant amendment bill into the Legislative Council in December 2018.

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Discussion

36. Mr Charles MOK said that while he was supportive to the legislative proposal in principle, he pointed out that the existing tax regimes for offshore funds was not conducive to local enterprises in raising funds from the domestic market as only offshore funds, but not onshore funds, might enjoy profits tax exemption. Moreover, at the investment level, offshore funds could not invest in local private companies if they wished to enjoy profits tax exemption. He criticized that the Administration would not have proposed the current legislative amendments to provide onshore funds with the same tax incentive as offshore funds should EU have not raised its concern about the problem associated with the ring-fencing features of the existing tax regimes for offshore funds. He stressed that in addition to engaging the fund industry, the Administration should conduct a public consultation to gauge views from relevant stakeholders (e.g. the business and technology sectors) on the proposed tax concession arrangements.

37. Mr Kenneth LEUNG concurred with Mr Charles MOK's view on the need for the Administration to consult relevant stakeholders on the proposal, in particular investees like start-up companies. He stressed that the Administration should strike a balance between avoiding tax evasion and promoting the development of the fund industry and capital market. He sought clarification on whether a private company whose main business was securities trading could take advantage of profits tax exemption by repackaging itself as an onshore fund.

38. DS(FS)1 clarified that the legislative proposal sought to address EU's concern about ring-fencing on one hand, and enhance the competitiveness of the asset and wealth management sector on the other. The Administration had conducted a four-week industry consultation to gauge views of the fund industry on the preliminary proposal and had taken into account the industry's feedback in arriving at the current proposal. He added that in order to reduce the risk of tax evasion by onshore businesses disguising themselves as funds, certain conditions would be imposed on a fund's investment in private companies, including the holding of immovable property in Hong Kong and short-term assets by the investee private companies. In general, if an investee private company held not more than 10% of its assets in immovable property in Hong Kong, and the investment in the private company had been held by the fund for at least two years, the fund would not be taxed on the profits arising from the transactions in securities of the private company.

39. In response to Mr Kenneth LEUNG's enquiry on tax evasion, Deputy Commissioner (Technical), Inland Revenue Department ("DC(T)") explained that to qualify for profits tax exemption, a fund which had not engaged a specified

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person should have at least five investors, and the fund's originator or the originator's associates would not be regarded as investors of the fund concerned.

40. Mr CHAN Chun-ying welcomed the proposal and supported imposing anti-tax avoidance measures. He suggested that the Administration should consider conducting a comprehensive review on the existing tax regimes with a view to identifying new tax concession arrangements with proper anti-avoidance measures, so as to increase Hong Kong's attractiveness as a place for establishment of funds and further promote the development of the professional services sector. DS(FS)1 took note of Mr CHAN's views.

41. Mr SIU Ka-fai enquired about the reasons of not providing profits tax exemption to onshore privately offered funds in previous legislative exercises, and whether profits tax exemption would be provided to funds investing in private companies with sales and leasing of real estate properties as their core business. He also sought information on the estimated tax revenue foregone resulting from the implementation of the current proposal.

42. DS(FS)1 said that the Administration had been keeping in view of the implementation of the tax regimes for funds and adopted a progressive approach in introducing tax concession arrangements for offshore and onshore funds. In order to address EU's concern and to avoid being listed by EU as a non-cooperative jurisdiction for tax purposes, the Administration considered it necessary to remove ring-fencing tax features for offshore funds by providing onshore funds with the same tax incentive as offshore funds. The Administration was also mindful of the need to address tax evasion in providing profits tax exemption to onshore funds. To reduce the potential risk of tax evasion by funds through their investments in private companies, it was proposed that if a fund invested in a private company that held, whether directly or indirectly, more than 10% of its assets in immovable property in Hong Kong, the fund would be taxed on the profits arising from such an investment in the private company concerned. DC(T) supplemented that a fund's direct investment in real estate properties would be subject to tax. Meanwhile, a private company which held properties and received investment from a fund would still be required to pay profits tax generated from profits deriving from the sales or letting of the properties held. As for revenue forgone, DS(FS)1 explained that the proposal should not give rise to significant revenue loss as compared to the current regimes. This was because the majority of funds operating in Hong Kong were offshore ones and were already enjoying tax exemption under the current tax regimes.

(At 11:44 am, the Chairman ordered that the meeting be extended for 10 minutes to 12:10 pm. Members agreed.)

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VI Any other business

43. There being no other business, the meeting ended at 12:07 pm.

Council Business Division 1
Legislative Council Secretariat
11 February 2019