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Hong Kong Special Administrative Region of the People's Republic of China

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LEGAL SERVICE DIVISION
LEGISLATIVE COUNCIL SECRETARIAT

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Dear Mr CHU,

Inland Revenue (Amendment) (Preferential Tax Regimes for Funds, Family-owned Investment Holding Vehicles and Carried Interest) Bill 2026

We are scrutinizing the captioned Bill with a view to advising Members on its legal and drafting aspects. We should be grateful if you could clarify the following issues.

Clause 3 – Proposed amended section 20AM

1. "Fund" is proposed to include:

(a) an arrangement (commonly known as a pension fund) that is established and operated in a jurisdiction exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals (proposed amended section 20AM(4)(b)(i) of the Inland Revenue Ordinance (Cap. 112) in clause 3(5)); and

(b) an arrangement (i) that is funded by only one participating person who does not have day-to-day control over the management of the property in respect of which the arrangement is made; and (ii) the value of the assets falling within a class specified in Schedule 16C ("qualifying assets") under management in which is not less than $240 million (proposed amended section 20AM(4)(e) of Cap. 112 in clause 3(5)).

For the purposes of the proposed new section 20AM(4)(e)(ii), the value of assets under management is to be determined in the manner specified by the Commissioner of Inland Revenue ("Commissioner") (proposed new section 20AM(4B) of Cap. 112 in clause 3(5)). Please clarify:

(a) what would be considered as "ancillary or incidental benefits" in the context of a pension fund under the proposed amended section 20AM(4)(b)(i) of Cap. 112;

(b) the valuation methodology for the $240 million threshold for qualifying assets for the purpose of the proposed amended section 20AM(4B) of Cap. 112, in particular, would the gross asset value or net asset value be used; and

(c) whether the words "in which" after the words "under management" in the proposed amended section 20AM(4)(e)(ii) of Cap. 112 (in its English version) are redundant and should be deleted.

2. Under the proposed new section 20AM(8) of Cap. 112 (clause 3(9)), a business undertaking would not be regarded as a business undertaking for general commercial or industrial purposes only because it carries out transactions in or derives profits from (a) qualifying assets (if it is not an open-ended fund company ("OFC")) or (b) any assets regardless of whether the assets are qualifying assets (if it is an OFC) (collectively "qualifying transactions"). The proposed amended section 20AM(7) of Cap. 112 lists examples of what would be included as a "business undertaking for general commercial or industrial purposes", including property development in Hong Kong or property holding in Hong Kong, banking, money-lending and insurance business. Please clarify what types of activities engaged in by a business undertaking would be considered as outside the scope of qualifying transactions under the proposed new section 20AM(8) of Cap. 112, in particular, whether the carrying out a single transaction e.g. a one-off property development in Hong Kong or holding a small amount of non-qualifying assets would cause the business undertaking to be regarded as a business undertaking for general commercial or industrial purpose and thus it would not be regarded as fund and would thus be ineligible for profits tax exemption.

Clause 4 – Proposed new section 20AMA

3. Clause 4 of the Bill seeks to add a new section 20AMA to Cap. 112 to require a fund to have at least two qualified employees and HK$2 million operating expenditure incurred in Hong Kong for carrying out investment management activities during the basis period as pre-conditions for profits tax exemption under section 20AN (proposed new section 20AMA(2)). "Investment management activity", in relation to a fund, is proposed to include "seeking funds for the fund" (proposed new section 20AMA(4)(a)). Please clarify whether seeking funds would include for example, marketing, fund raising events and preparing offering documents.

Clauses 5 and 26 – Proposed amended section 20AN(3) and proposed amended section 9(4) of Schedule 16E

4. Clauses 5(9) and 26(9) of the Bill seek to amend section 20AN(3) of and section 9(4)(b) of Schedule 16E to Cap. 112, which set out the conditions a fund and a family-owned investment holding vehicle must satisfy to qualify for profits tax exemption. Under the proposed amended section 20AN(3)(a)(i) of and the amended section 9(4)(b)(i) of Schedule 16E to Cap. 112, qualifying assets would have to be primarily managed in Hong Kong. Please clarify how "primarily managed" would be determined, in particular, whether it refers to the location where most of the qualifying assets are located or where the majority of investment decisions are made.

Clause 5 – Proposed amended section 20AN(5)

5. Under the proposed amended section 20AN(5) of Cap. 112 (clause 5(12)), the Commissioner of Inland Revenue ("Commissioner") may by notice published in the Gazette amend the proposed new Schedule 16L (i.e. income that is derived from shares or stocks of a private company and is attributable to property trading or property development in respect of immovable property in Hong Kong). Please clarify whether the notice under the proposed amended section 20AN(5) of Cap. 112 would be subsidiary legislation subject to the negative vetting procedure of the Legislative Council ("LegCo") and if so, please consider expressly provide for it in the Bill (and if not, the reason(s) for that).

Clauses 7 and 26 – Proposed amended section 20AP and proposed amended section 1 of Schedule 16E

6. Under the proposed amended section 20AP(4) (clause 7(13)) of and the proposed amended section 1(1) of Schedule 16E to Cap. 112 (clause 26(2)), "equity interest", in relation to an entity, is proposed to mean an interest that (a) carries rights to the profits, capital or reserves of the entity; and (b) is accounted for as equity, in the financial statements of the entity, under applicable accounting

principles. Please clarify what would be the applicable accounting principles for the purpose of the proposed new definition of "equity interest".

Clause 9 – Proposed amended section 20AS

7. Under the proposed amended section 20AS of Cap. 112 (clause 9), if, during the basis period for a year of assessment, an OFC carries on a direct trading or direct business undertaking in Hong Kong in non-qualifying assets, the company would not be exempt from the payment of tax chargeable under Part 4 of Cap. 112 in respect of its assessable profits for the basis period derived from the trading or business undertaking. Under the proposed amended section 20AN(2)(b) of Cap. 112 (clause 5(5)), an OFC is exempt from profits tax in respect of its assessable profits derived from any assets regardless of whether the assets are qualifying assets. Please clarify:

(a) what constitutes "direct trading" and "direct business undertaking" for the purposes of the proposed amended section 20AS of Cap. 112 and whether the Inland Revenue Department ("IRD") would issue guidance setting out the factors to determine whether an OFC's activities constitute a "direct trading or direct business undertaking"; and

(b) the reason for denying an OFC's profits tax exemption under the proposed amended section 20AS for direct trading or direct business undertaking in non-qualifying assets given that the OFC's tax exemption under the proposed amended section 20AN(2)(b) of Cap. 112 applies to any assets (regardless of whether it is a qualifying asset).

Clause 12 – Proposed amended section 20AW

8. Under the proposed new section 20AW(10) of Cap. 112, a person's "control" over a fund or special purpose entity ("SPE") is proposed to mean that if the fund or SPE is accustomed or under an obligation to act, in relation to the investment or business affairs of the fund or SPE, in accordance with the directions, instructions or wishes of the person. A person would be construed as having "significant influence" over a fund or SPE if the person has power to participate in the financial and operating policy decision of the fund or SPE (proposed new section 20AW(11)(a)). Please clarify whether persons acting in a professional capacity e.g. lawyers, accountants and tax advisers, whose advice would be acted on and who would participate in the financial and operating policy decision, would be considered as having control or significant influence over the fund or SPE in the context of the proposed new section 20AW(10) and (11) of Cap. 112.

Clause 15 – Proposed new section 20AZ

9. Under the proposed new section 20AZ(3) of Cap. 112, subject to section 20AZ(4), the filing of initial notification and annual notification obligations under the proposed new sections 20AZA and 20AZB of Cap. 112 would not apply to a specified person of a specified fund for a year of assessment if the fund is a limited partnership fund or OFC. The proposed new section 20AZ(4) provides that a limited partnership fund and an OFC may make an election to use the reporting regime under sections 20AZA and 20AZB instead of filing tax returns under section 51(1) of Cap. 112 under specified circumstances (e.g. the fund has no assessable profits other than those in respect of which the fund is exempt from the payment of tax under section 20AN). Please clarify the rationale for exempting a specified person from filing initial and annual notifications where the fund is a limited partnership fund or an OFC under the proposed new section 20AZ(3)(c) of Cap. 112 and the reasons for not extending the exemption to other types of funds.

Clause 15 – Proposed new section 20AZA

10. Pursuant to the proposed new section 20AZA(1) of Cap. 112, a specified person of a specified fund (i.e. the person responsible for the management or administration of the fund or any part of the fund in that year of assessment (proposed new section 20AZ(1)(b))) has a duty to file a written notice in respect of the fund with the Commissioner within a period of six months beginning on the date on which the person begins to manage or administer the fund or part of the fund. A specified fund may designate a specified person of the fund in Hong Kong for the purposes of the proposed new section 20AZA of Cap. 112 (proposed new section 20AZA(3) of Cap. 112). If a specified person ceases to be a designated person of the fund, any other specified person must file a written notice with the Commissioner within a period of six months beginning on the date on which the cessation takes place (proposed new section 20AZA(6) of Cap. 112). Please clarify:

(a) the scope of "specified person" (where there are multiple parties in a fund structure) for the purpose of filing initial and annual notifications and whether it includes a fund manager, fund administrator or custodian;

(b) whether the reporting obligations would fall on all specified persons jointly and severally if a fund fails to make a designation under the proposed new section 20AZA(3) of Cap. 112 ; and

(c) for the purposes of the proposed new section 20AZA(6) of Cap. 112, how would "any other specified person" be identified in the event of a specified person ceases to be a designated person of the fund.

Would there be a positive duty on the fund to designate another person as a specified person for the purposes of filing the initial notification and annual notification after a specified person ceases to be a designated person? If so, please consider if it would be necessary to provide for that expressly.

11. Under the proposed new sections 20AZA(11) and 20AZB(2) of Cap. 112, an initial notification and annual notification must be filed in an electronic record that is sent by using the designated system and contains all information specified by the Board of Inland Revenue. Please clarify what kind of information would be required to be reported and whether IRD would issue detailed guidance in this regard.

Clause 15 – Proposed new section 20AZC

12. Under the proposed new section 20AZC(1) of Cap. 112, for the purposes of the proposed new sections 20AZA(11)(a) and 20AZB(2)(a), the Commissioner may designate a system for communication with the Commissioner. Under the proposed new section 20AZC(3), the Commissioner may either generally or in a particular case, accept an initial notification or annual notification, despite a requirement under section 20AZA(11) or 20AZB(2) not being complied with in respect of the notification. Please clarify:

(a) the circumstances under which the Commissioner could accept an initial notification or annual notification despite a requirement under the proposed new section 20AZA(11) or 20AZB(2) not being complied with, in particular, whether the discretion to be exercised under the proposed new section 20AZC(3) would be limited to technical or procedural non-compliance (e.g. incorrect file format or missing digital signature); and

(b) whether the Commissioner would be required to provide reasons for accepting or rejecting an initial or annual notification which has not complied with the requirements and whether the specified person would be given an opportunity to remedy the non-compliance.

13. Under the proposed new section 20AZC(2) of Cap. 112, the Commissioner may, by notice published in the Gazette, specify requirements as to (a) the way of generating or sending an electronic record for the purposes of filing the initial and annual notifications or any attachment required to be given with such electronic record; (b) how a digital signature is to be affixed to an initial notification or annual notification; and (c) the software and communication in relation to any attachment required to be given with an electronic record. Under the proposed new section 20AZC(4), a notice under the proposed new

section 20AZC(2) would not be subsidiary legislation (proposed new section 20AZC(4)). Please clarify:

(a) the rationale that the notice to be made by the Commissioner under the proposed new section 20AZC(2) would not be subsidiary legislation subject to LegCo's scrutiny; and

(b) whether there would be a mechanism in place to ensure that technical requirements under the proposed new section 20AZC(2) are reasonable and proportionate.

Clause 19 – Proposed new section 80(2ZF)

14. Under the proposed new section 80(2ZF) of Cap. 112 (clause 19(2)), a person who, without reasonable excuse, fails to comply with the proposed new section 20AZA(1), (4), (6) or (9) or 20AZB(2) in relation to the filing of initial notification or annual notification, would commit an offence and would be liable on conviction to a fine at level 3 (i.e. $10,000). The new offences appear to be intended to be strict liability offences, please confirm whether that is the case. Please also clarify:

(a) whether the availability of the statutory defence of "reasonable excuse" displaces the implied common law defence of "honest and reasonable mistaken belief";

(b) if the statutory defence does not displace the common law defence, whether the defendant would bear an evidential burden in proving his belief under the common law defence, or he would be required to discharge a persuasive burden of proof; and

(c) if the defendant would be required to discharge a persuasive burden of proof, whether it is consistent with Article 87 of the Basic Law and Article 11(1) of the Hong Kong Bill of Rights Ordinance (right to be presumed innocent) and how it could satisfy the rationality and proportionality tests laid down in *Hysan Development Co Ltd v Town Planning Board* [2016] 6 HKC 58.

Clauses 19 and 20 – Proposed new sections 80(2ZI) and 80Y

15. It is noted that the proposed new sections 80(2ZI) (clause 19(2)) and 80Y(2) of Cap. 112 (clause 20) introduce new offences where the statutory defence of "reasonable excuse" is not specified. Please clarify whether it is the Administration's legislative intent that each of these proposed new offences would be a strict liability offence or an absolute liability offence. For each of these offences intending to be a strict liability offence, please refer to the issues set out

in paragraph 14 above and clarify. For each of these offences intending to be an absolute liability offence, please provide justification(s) for making it an absolute liability offence.

Clause 24 – Proposed amended Schedule 16C

16. Clause 24 proposes to amend Schedule 16C to Cap. 112 by expanding the scope of qualifying assets by including precious metal, at the value not exceeding 20% of the investment portfolio during the basis period of a year of assessment (proposed new item 8A in Part 1 of Schedule 16C to Cap. 112 in clause 24(5)). For the purposes of the proposed new item 8A of Part 1 of Schedule 16C to Cap. 112, the value of precious metal, and the investment portfolio, during the basis period of a year of assessment would be determined in the manner specified by the Commissioner (proposed new section 3 of Part 2 in Schedule 16C to Cap. 112 in clause 24(10)). "Precious metal" is proposed to mean gold, silver, platinum, iridium, osmium, palladium, rhodium or ruthenium, in a manufactured or unmanufactured state, except any exchange-traded commodity (clause 24(10)). "Exchange-traded commodity" means gold or silver traded on a commodity exchange in Hong Kong to which the Commodity Exchanges (Prohibition) Ordinance (Cap. 82) does not apply by virtue of section 3(d) of Cap. 82 (section 1 of Part 2 of Schedule 16C to Cap. 112). Please clarify:

(a) whether "precious metal" as defined covers precious metals held in physical form (e.g. bullion) as well as those held through exchange-traded funds;

(b) the rationale for excluding "exchange-traded commodity" from the definition of "precious metal" given that both refers to gold or silver; and

(c) how should the value of precious metals be calculated for the purpose of computing the 20% cap of the investment portfolio, whether the valuation would be based on market value, cost or other factor(s).

17. Clause 24 proposes to add emission allowance, emission derivatives and carbon credits as qualifying assets (proposed new items 15, 16 and 17 in Part 1 of Schedule 16C to Cap. 112 in clause 24(7)). Under subclause (9), certain definitions are proposed, it is noted that "carbon credit" is proposed to mean in particular, an instrument that represents the reduction, removal or avoidance of greenhouse gases and is traded on a trading platform for climate-related products recognized by the Secretary for Financial Services and the Treasury ("SFST") under the proposed new section 2 of Part 2 of Schedule 16C to Cap. 112. "Emission allowance" is proposed to mean an instrument that conveys a right to emit greenhouse gases and that is traded on a trading platform for climate-related

products recognized by SFST under the proposed new section 2 of Part 2 of Schedule 16C to Cap. 112. "Emission derivative" is proposed to mean a derivative the payoffs of which are wholly or substantially linked to the payoffs or performance of the underlying emission allowance or carbon credit. Please clarify:

(a) the meaning of "climate-related products" and provide examples;

(b) the process for recognizing a "trading platform for climate-related products" under the proposed new section 2 of Part 2 of Schedule 16C to the Bill and whether SFST would publish a list of recognized platforms for public's information; and

(c) the threshold that would constitute "substantially linked" in the context of emission derivative.

Clause 25 – Proposed amended Schedule 16D

18. Under the proposed amended section 10(1) of Schedule 16D to Cap. 112 (clause 25(44)), a qualifying person must take reasonable steps to ascertain whether eligible carried interest is or will be received by, or accrued to, a qualifying employee of the person or of a closely related entity of the person in a year of assessment as a result of the provision of investment management services in Hong Kong by the employee for, or on behalf of, the person. Please clarify what would be "reasonable steps" that a qualifying person would have to take to ascertain whether eligible carried interest is or will be received by a qualifying employee, and whether IRD would issue guidance to ensure compliance.

19. Under the proposed new sections 10(3)(a)(ii) and (iii) and 10(3)(b)(v) and (vi) of Schedule 16D to Cap. 112 (clause 25(44)), where a qualifying person claims profits tax concession on the eligible carried interest received by or accrued to the person, and where a qualifying employee claims salaries tax concession on carried interest received by or accrued to the employee, the qualifying person must provide details of the qualifying payer and any other information relating to the eligible interest, as specified by the Commissioner. Please clarify what kind of details of qualifying payers and information relating to the eligible interest that would have to be provided.

20. Under the proposed amended section 11(4)(b) in Schedule 16D to Cap. 112 (clause 25(46)), if a qualifying payer fails to comply with information and record-keeping obligations under section 11(2) and (3) of Schedule 16D to Cap. 112 (i.e. provide information required by the Commissioner and keep sufficient records and retain the same for not less than seven years), the Commissioner could determine that the claim made by the qualifying

person/employee for profits/salaries tax concessions in relation to the eligible carried interest paid or accrued to the person/employee by the qualifying payer is not to be assessed. Please clarify the factors that the Commissioner would consider for determining whether or not to deny profits/salaries tax concessions where the qualifying payer fails to comply with the relevant obligations.

Clause 26 – Proposed amended Schedule 16E

21. Clause 26(3) and (4) of the Bill seeks to amend section 6(2)(b) of Schedule 16E to Cap. 112 to expand the scope of activities for family-owned SPE to include (i) acquiring, holding (whether directly or indirectly), administering or disposing of either or both of (A) one or more investee private companies; (B) any qualifying assets; or (ii) for carrying out an activity incidental to the purpose mentioned in (i). Please provide examples of what would be considered as "incidental activities" and whether there would be any threshold applicable to the income from such incidental activities.

We look forward to receiving your reply in both English and Chinese as soon as practicable.

Yours sincerely,

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