Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By email (bc_08_16@legco.gov.hk) and by hand

5 September 2017

Our Ref.: C/TF, BH37053

Hon. Kenneth Leung
Chairman,
Bills Committee on Inland Revenue (Amendment) (No.4) Bill 2017,
Legislative Council Complex,
1 Legislative Council Road,
Central, Hong Kong

Dear Mr Leung,

Inland Revenue (Amendment) (No. 4) Bill 2017

The Tax Faculty ("TF") of the Hong Kong Institute of Certified Public Accountants ("Institute") has reviewed the Inland Revenue (Amendment) (No.4) Bill 2017 ("the Bill") and would like to submit views on the Bill as explained below.

The Bill proposes to extend a profits tax exemption to privately-offered open-ended fund companies ("OFC") with their central management and control exercised in Hong Kong. We believe that the policy objective should be to facilitate the continuing development Hong Kong's asset management industry, as an important contributor to Hong Kong's international standing as financial centre and as a source of employment. As such, one aim of the measures in the Bill should be to incentivise the industry to choose Hong Kong as a preferred location for domiciling funds, bearing in mind the competition from other popular locations for asset management (e.g., Cayman Islands and Singapore).

However, there are aspects of proposals, which, in the view of TF members, may result in the Bill not achieving that objective. For instance, the "non-closely held ('NCH')" conditions require a minimum number of investors (five investors, if there is a qualified investor or, otherwise, ten investors), which, together with the minimum investment requirement, means that only funds of a certain size would be eligible for the regime. The Legislative Council Brief indicates that the condition is intended to prevent an OFC from being held by a small number of investors, which could result in the tax exemption being subject to abuse. While we appreciate the need to discourage abuses, we would not wish to close the door to many legitimate OFCs wishing to set up in, or relocate to, Hong Kong because they cannot meet the necessary threshold.

Under the NCH condition, aside from a qualified investor, each investor is required to invest at least HK$20 million in the OFC. This contrasts with the minimum investment threshold necessary to establish a fund in, for example, the Cayman Islands, which is set at US$100,000.

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If the proposed regime is seen as being too onerous relative to those in other jurisdictions, the outcome may well fail to live up to expectations. We suggest that the above requirements should be reconsidered and, where possible, made more flexible to achieve a better balance between safeguarding against possible abuses and accommodating a range of possible funds and fund sizes.

In addition to the above, the proposed NCH conditions could give rise to other complexities. It would appear that a fund could easily become taxable in future years, because, for example, a single investor redeems part of its investment, causing the fund to fall below the required investment threshold of HK$200 million (for the qualified investor) or HK$20 million each (for other investors). While we note that safe harbour rules are proposed, given that these are to be applied at the discretion of the Commissioner of Inland Revenue, there will continue to be uncertainty as to whether the exemption will be given in any particular year. This will not encourage OFCs that just meet the minimum requirements to establish in Hong Kong.

On the tax treatment of performance fees and carried interest paid in the form of dividends to investment managers, TF members believe that taxing these as normal assessable income or profit, may not attract more asset managers to set up business in Hong Kong. We suggest, therefore, that consideration be given to taxing this income at a reduced rate of profits tax of, say 10%, for qualifying Hong Kong asset managers.

With regard to the proposed new section 20AJ(3), prima facie, it would seem to be asymmetrical and potentially inequitable, if on one hand, dividend income received by the investment manager were to be taxed, while, at the same time, the fund were to be disallowed an exemption from profits tax.

We note that the Bill does not specify the treatment of stamp duty, which appears to suggest that the transfer of shares would attract stamp duty (other than initial allotment and cancellation upon redemption for unit trusts). Given that transfers of shares in offshore funds are not subject to stamp duty in Hong Kong, this suggests that the proposed regime will be less favourable than the offshore funds regime.

We suggest, therefore, that there are a number of issues that should be reconsidered and/ or clarified. While, in some cases, these may be regarded as matters of interpretation and practice and may be able to be addressed through departmental interpretation and practice notes issued by the Inland Revenue Department, other issues would need to be dealt with in the Bill itself. Even for the former, the department should make its position clear during the passage of the Bill.

It is indicated in the Legislative Council Brief that the proposed regime should not be regarded as a harmful tax practice by the Organisation for Economic Co-operation and Development ("OECD"), in the context of the OECD's Base Erosion and Profits Shifting action plans. We believe that the situation should continue be monitored so as to reduce the risk of having to reappraise the proposed measures within a short space of time, due to subsequent interpretations or developments internationally.

Should you have any questions on this submission, please contact me at 2287 7084 or peter@hkicpa.org.hk

Yours sincerely,

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