

## **LEGISLATIVE COUNCIL BRIEF**

Inland Revenue Ordinance  
(Chapter 112)

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

#### **INTRODUCTION**

A At the meeting of the Executive Council on 4 December 2018, the Council **ADVISED** and the Chief Executive **ORDERED** that the Inland Revenue (Profits Tax Exemption for Funds) (Amendment) Bill 2018 (“the Bill”), at **Annex A**, should be introduced into the Legislative Council (“LegCo”) to provide profits tax exemption to eligible funds operating in Hong Kong.

#### **JUSTIFICATIONS**

##### **Development of Hong Kong’s asset and wealth management industry**

2. Asset and wealth management (“WAM”) is a fast-growing sector within the financial services industry. As at 31 December 2017 (year with latest available figures), the total assets under management by WAM business in Hong Kong amounted to US\$3.1 trillion<sup>1</sup>. One of our major policy objectives in further developing the WAM industry is to attract more funds of various types to base and develop their business in Hong Kong. To achieve this objective, we have implemented, and will continue to implement, measures to enhance our legal framework to enable funds to be created in Hong Kong under different structures<sup>2</sup>,

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<sup>1</sup> The data is obtained from the Asset and Wealth Management Activities Survey 2017 conducted by the Securities and Futures Commission (“SFC”). In the survey, WAM business comprises asset management, fund advisory business, private banking and private wealth management business, and business of managing real estate investment trusts authorised by the SFC.

<sup>2</sup> A fund can be in the structure of, for example, a unit trust, corporation or limited partnership.

broaden the distribution network for fund products, and provide a more favourable tax environment for funds.

### **Current tax treatment for funds**

3. Tax treatment is a key factor influencing the choice of jurisdiction for fund domiciliation and management. Under the Ordinance, publicly offered funds, both onshore and offshore<sup>3</sup>, are already exempted from profits tax. For privately offered funds, only offshore funds can enjoy profits tax exemption<sup>4</sup>. These include offshore privately offered funds and offshore private equity funds (collectively known as “offshore funds” hereafter). Given that onshore privately offered funds cannot enjoy profits tax exemption like their offshore counterparts, it may not be conducive to the further development of Hong Kong’s WAM industry. This is because this tax disparity will disincentivise funds to domicile and/or be managed in Hong Kong when domiciliation and management will drive demand for other professional services such as fund administration and investment advice, as well as legal, accounting and other ancillary services.

### **European Union’s concerns and Hong Kong’s commitment**

4. Based on the latest Base Erosion and Profit Shifting standard of the Organisation for Economic Co-operation and Development, the Council of the European Union (“EU”) has identified Hong Kong’s tax regimes for offshore funds to be problematic on account of their ring-fencing features<sup>5</sup>. Our tax regimes are considered harmful at two levels. At the fund level, they are considered harmful as the Ordinance currently

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<sup>3</sup> Funds with their CMC exercised in Hong Kong are regarded as “onshore funds”. Those with their CMC exercised outside Hong Kong are regarded as “offshore funds”. The CMC test is well established in common law for determining the residence of corporations, partnerships and trusts.

<sup>4</sup> The only exception is onshore privately offered open-ended fund companies. This type of onshore fund can enjoy profits tax exemption since July 2018 with the passage of the Inland Revenue (Amendment) (No. 2) Ordinance 2018. Further details are set out in Footnote 9 below.

<sup>5</sup> Ring-fencing occurs where the preferential tax treatment is partially or fully isolated from the domestic economy. It may take different forms, e.g. excluding resident taxpayers from taking advantage of the preferential tax treatment; and prohibiting qualifying resident taxpayers from operating in the domestic market. Qualifying resident taxpayers can be implicitly excluded from operating in the domestic market if the applicability of the preferential tax treatment is limited to transactions carried out with foreign parties.

provides profits tax exemption to offshore, but not onshore, funds as explained in paragraph 3 above. At the investment level, they are considered harmful as the Ordinance currently allows offshore funds with investment in private companies to enjoy tax exemption only if those companies are incorporated overseas but not locally.

5. To further consolidate Hong Kong's competitive edge in the manufacturing and management of funds and in order not to be put on the EU's list of non-cooperative jurisdictions for tax purposes, the Government announced in the 2018-19 Budget that a review would be conducted on the existing tax concession arrangements applicable to the fund industry with regard to the international requirements on tax co-operation. A task force led by the Financial Services and the Treasury Bureau and comprising members from the Inland Revenue Department, the Hong Kong Monetary Authority, and the SFC has been formed to conduct the review. Specifically, Hong Kong has committed to look into how to modify the tax regimes for offshore funds to address the EU's concerns about ring-fencing, and introduce the corresponding legislative amendments into LegCo by end-2018. Failure to honour the aforementioned commitment may lead to the EU revisiting Hong Kong's status when reviewing the list of non-cooperative jurisdiction for tax purposes, and expose Hong Kong to defensive measures (e.g. reinforced monitoring of certain transactions and withholding tax measures) which may be imposed by EU Member States.

## **THE PROPOSAL**

6. In addressing the EU's concern, we are guided by the principle of making changes that are necessary to remove ring-fencing tax features for fund entities<sup>6</sup> while leaving intact other features under our existing tax regimes that are not related to fund entities per se. We have also taken the opportunity to adjust certain tax treatment for funds so that Hong Kong remains competitive in the face of increasing regional and international competition. The proposal is elaborated in paragraphs 7 to 15 below. New and self-contained provisions on the tax treatment for funds will be added to the Ordinance to achieve these purposes.

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<sup>6</sup> There are no tax disparity issue and ring-fencing concerns in relation to publicly offered funds. The current exercise is on privately offered funds only.

## **Removal of ring-fencing at the fund level**

7. Our objective is to attract funds of different types and sizes to Hong Kong. We therefore propose that all funds, regardless of their structure, their CMC location, their size or the purpose that they serve, will enjoy profits tax exemption subject to meeting the conditions set out in paragraphs 12 to 15 below. A definition of “fund”, similar to the definition of “collective investment scheme” in Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) (“SFO”), will be added to the Ordinance for this purpose. The definition of “fund” is set out in the newly introduced section 20AM of the Bill at Annex A. In line with the existing tax exemption arrangements for offshore funds, we propose to require an entity meeting the definition of “fund” to engage a specified person<sup>7</sup> to arrange or carry out its transactions in Hong Kong or be a “qualifying fund”<sup>8</sup>.

## **Removal of ring-fencing at the investment level**

8. At present, offshore funds may enjoy tax exemption on profits from certain transactions and transactions incidental to the carrying out of these transactions. These transactions are basically transactions in securities and other kinds of financial products that a fund would commonly find of interest. As for onshore privately offered open-ended fund companies (“OFCs”), they may also enjoy tax exemption on profits from transactions in non-qualifying assets<sup>9</sup>. To maintain the status quo

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<sup>7</sup> A “specified person” is currently defined in the Ordinance as a corporation licensed under Part V of the SFO to carry on, or an authorised financial institution registered under that Part for carrying on, a business in any regulated activity as defined by Part 1 of Schedule 5 to the SFO.

<sup>8</sup> A “qualifying fund” is currently defined in the Ordinance as a fund with at least five investors; the capital commitments to the fund made by the investors should exceed 90% of the aggregate capital commitments; and the distribution of the net proceeds of the fund to the originator and its associates should not exceed 30%.

<sup>9</sup> To diversify our fund management platform, the Government has put in place a legal framework for a new fund structure in the form of OFCs in Hong Kong. The OFC regime allows funds to be set up in the form of a company, but with the flexibility to create and cancel shares for investors’ subscription and redemption in the funds. The OFC regime commenced operation on 30 July 2018.

Prior to the passage of the Inland Revenue (Amendment) (No.2) Ordinance 2018 in March 2018, publicly offered OFCs and offshore OFCs can enjoy profits tax exemption but not onshore privately offered OFCs. The Government has amended the law so that all OFCs can enjoy profits tax exemption.

As the OFCs are subject to the SFC’s regulation (including the 10% de minimis limit based on gross asset value which allows flexibility for them to invest in non-qualifying assets) on an ongoing basis, they can enjoy profits tax exemption on transactions in non-qualifying assets as well.

of the aforementioned funds to avoid market confusion and ensure that there is a level playing field, we propose that an entity that meets the definition of “fund” and fulfills the specified person or qualifying fund requirement as outlined in paragraph 7 above will be able to enjoy profits tax exemption on its profits generated from the following transactions –

- (a) transactions in qualifying assets (“qualifying transactions”);
- (b) transactions incidental to the carrying out of qualifying transactions (“incidental transactions”), subject to a 5% limit; and
- (c) if the fund is an OFC, transactions in non-qualifying assets (“non-qualifying transactions”).

9. A list of the qualifying assets is in Schedule 16C of the Bill at Annex A. In drawing up this list, we have considered the current tax regimes for offshore funds and OFCs to ensure that the tax exemption currently enjoyed by these funds will not be affected. To remove the ring-fencing feature at the investment level, a fund can enjoy profits tax exemption on its investment in both overseas and local private companies. Separately, we propose that there will be no tainting effect, i.e. the tax-exempt profits of the fund will not be tainted even if a fund is taxed on its non-qualifying transactions.

10. The proposed tax treatment for incidental transactions under paragraph 8(b) above is the same as the current tax treatment for such transactions. If the 5% threshold is exceeded, the whole of the receipts from the incidental transactions will be chargeable to profits tax.

11. It is quite common for a fund to set up special purpose entities (“SPEs”) for the sole purpose of holding and administering investment in private investee companies. As with the current practice, we propose that tax exemption will be provided at both the fund level, and if there is SPE, the SPE level to the extent which corresponds to the percentage of shares or interests of the SPE held by the fund.

## Anti-tax avoidance measures

### *Requirements for investment in private companies*

12. Private companies may hold any type of assets in Hong Kong. In order to reduce the risk of tax evasion<sup>10</sup> by funds through their investment in private companies, we propose that a fund will be taxed on its profits from such investment that do not meet the following three tests

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- (a) **immovable property test:** if a fund invests in a private company that holds, whether directly or indirectly, more than 10% of its assets in immovable property (excluding infrastructure) in Hong Kong<sup>11</sup>, the fund will be taxed on the profits arising from such an investment in the private company;
- (b) **holding period test:** if the private company (i) does not hold, whether directly or indirectly, any immovable property in Hong Kong; or (ii) holds, whether directly or indirectly, not more than 10% of its assets in immovable property in Hong Kong, and the investment in the private company has been held by the fund for at least two years, the fund will **not** be taxed on the profits arising from the transaction of the private company. If the private company has been held by the fund for less than two years, the short-term asset test described in (c) below will apply;
- (c) **short-term asset test:** if the holding period test at (b) above cannot be satisfied, profits tax exemption would only be provided if –
  - (i) the fund does not have a controlling stake in the private company; or
  - (ii) the fund has a controlling stake in the private company,

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<sup>10</sup> For example, trading assets chargeable to profits tax upon sale may become tax-exempted if the sale is structured through a fund which sells shares in a private company holding such trading assets.

<sup>11</sup> Infrastructure includes bridges, tunnels, roads and the like.

The Government has considered whether this may be a ring-fencing feature. In general, the source jurisdiction has the right to tax gains from indirect transfer of immovable property located within its jurisdiction. The resident jurisdiction equally has the right to tax its own residents. Based on these principles, Hong Kong may not be able to tax capital gains derived from overseas immovable property (i.e. Hong Kong is neither the source jurisdiction nor the resident jurisdiction). Therefore, it would not be appropriate to carve out overseas immovable property as well.

but the latter does not hold more than 50% of the value of the company's assets in short-term assets. Short-term assets are assets (excluding qualifying assets and immovable property in Hong Kong) held by the private company for less than three years at the time of the transaction.

B The diagram at **Annex B** shows how the above tests would operate in practice. The immovable property test and short-term asset test are not new. They have been used in the tax exemption regime for onshore privately offered OFCs before. The holding period test is added to cater for the genuine operational needs of private equity funds.

13. Separately, profits tax exemption is currently provided for investment co-invested in private companies by the Innovation and Technology Commission (“ITC”)’s Innovation and Technology Venture Fund (“ITVF”) and the partner funds of ITVF. We propose that this should be maintained. Further, given that the co-investment is subject to the control and monitoring of the ITC (including that the investee private companies have to meet the criteria for “Eligible Local Innovation and Technology Start-up” of the ITVF scheme), we propose that the co-investment transactions do not need to be subject to the above three tests. Yet, investment in private companies by the partner funds on their own (i.e. not co-investment with the ITVF) will be subject to the three tests.

#### *Prevention of abuse by businesses*

14. To reduce the risk of tax abuses by onshore businesses repackaging themselves as funds, we propose to make it clear that a business undertaking for general commercial or industrial purpose is not a fund. For the sake of clarity, a fund's engagement in “qualifying transactions” will not be regarded as a business undertaking for general commercial or industrial purpose.

#### *Tax treatment of resident persons*

15. To prevent tax leakage, we propose to keep the current anti-round tripping provisions in the Ordinance, i.e. a resident person who, either alone or jointly with his associates, has a beneficial interest of 30% or more in a tax-exempt fund (or any percentage if the fund is the resident person's associate) will be deemed to have derived assessable profits in respect of the trading profits earned by the fund from the qualifying

transactions. This aims to prevent abuse or round-tripping by a resident person disguising as a fund to take advantage of the exemption.

## **OTHER MATTERS**

### *OFCs*

16. We have put in place profits tax exemption arrangements for onshore privately offered OFCs vide the Inland Revenue (Amendment) (No. 2) Ordinance 2018 (please see Footnote 9 above). To ensure that there is a level playing field and avoid market confusion, we consider it appropriate that the tax treatment for funds as set out in paragraphs 7 to 15 above should be applied to OFCs. We have made suitable amendments to the existing provisions in the Ordinance to give effect to this.

### *Tax treatment of remuneration of investment managers*

17. The current principles on taxation of remuneration to investment managers will remain unchanged and we do not see a need to introduce any specific provisions in the Bill. The principles are that remuneration received by investment managers in respect of their professional services provided in Hong Kong will be subject to taxation.

## **OTHER OPTIONS**

18. We must amend the Ordinance to provide profits tax exemption for both onshore and offshore funds and remove the ring-fencing features identified by the EU. There is no other option.

## **THE BILL**

19. The main provisions of the Bill are as follows –

- (a) clause 4 amends section 20AC of the Ordinance such that, on and after 1 April 2019, a reference in the section to a non-resident person does not include a fund within the meaning of section 20AM;

- (b) clause 5 repeals sections 20AG to 20AL of the Ordinance to align the tax treatments for OFCs with the new definition of fund;
- (c) clause 6 adds new sections 20AM to 20AY to the Ordinance
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- (i) the new section 20AM provides for a new definition of fund for the purposes of the new sections 20AN to 20AY and Schedules 15C, 15D and 16C;
  - (ii) the new section 20AN provides for the exemption of a fund from payment of profits tax in respect of its assessable profits in relation to certain transactions if certain conditions are met;
  - (iii) the new section 20AO exempts an SPE from profits tax to an extent corresponding to the percentage of shares or interests that a tax-exempt fund holds in the SPE;
  - (iv) the new sections 20AP and 20AQ deal with when an exemption under section 20AN or 20AO does not apply to funds and SPEs. They set out the three tests on investment in private companies as mentioned in paragraph 12 above (“three tests”);
  - (v) the new section 20AR is a supplementary provision to sections 20AP and 20AQ. It provides that the three tests do not apply to co-investment by an ITVF partner fund in a private company under the ITVF scheme;
  - (vi) the new section 20AS provides that an OFC is not exempt from tax in respect of its assessable profits for the period earned from the trading, business undertaking or utilisation of non-qualifying assets to generate income;
  - (vii) the new section 20AT provides for the tax treatment for sub-funds of OFCs;

- (viii) the new sections 20AU and 20AV set out the circumstances under which the losses sustained by a fund under certain conditions may be set-off against the assessable profits of the fund;
  - (ix) the new section 20AW is an interpretation provision for the new sections 20AX and 20AY and the new Schedules 15C and 15D; and
  - (x) the new sections 20AX and 20AY provide that the assessable profits of a fund or SPE are regarded as the assessable profits of a resident person if the resident person has, in a year of assessment commencing on or after 1 April 2019, a beneficial interest, whether direct or indirect or both, in a fund to the extent that the person, either alone or jointly with any of the person's associates, holds not less than 30% of the interest in the fund or SPE;
- (d) clause 7 repeals Schedule 15B which is applicable for ascertaining the amount of assessable profits of resident persons in an OFC. This is no longer required as the new definition of fund covers an OFC;
- (e) clause 8 adds new Schedules 15C and 15D to the Ordinance. Schedule 15C sets out the provisions for ascertaining the amount of assessable profits of resident person under section 20AX, while Schedule 15D sets out the provisions for ascertaining the amount of assessable profits of resident persons under section 20AY. The new Schedules follow the existing Schedules 15 and 15A in governing the calculation of such assessable profits;
- (f) clause 9 amends Schedule 16 to the Ordinance to update a reference;
- (g) clause 10 repeals Schedule 16A which concerns the class of assets specified for the purposes of section 20AH; and Schedule 16B which concerns the non-closely held requirement for OFCs. These Schedules are no longer required since sections 20AH and 20AI are to be repealed;

- (h) clause 11 adds new Schedule 16C to the Ordinance. Schedule 16C sets out the classes of assets specified for the purposes of section 20AN; and
- (i) clause 12 amends Schedule 17A to the Ordinance to update certain references.

## **LEGISLATIVE TIMETABLE**

20. The legislative timetable will be –

Publication in the Gazette	7 December 2018
First Reading and commencement of Second Reading debate	12 December 2018
Resumption of Second Reading debate, committee stage and Third Reading	To be notified

## **COMMENCEMENT**

21. The Bill will come into operation on 1 April 2019.

## **IMPLICATIONS OF THE PROPOSAL**

22. The Bill is in conformity with the Basic Law, including the provisions concerning human rights. It will not affect the current binding effect of the existing provisions of the Ordinance. There are no productivity, environmental, family or gender implications, and no sustainability implications other than the economic implications set out in paragraph 24 below. At this stage, there are also no civil service implications for the Government as the Inland Revenue Department (“IRD”) will absorb the additional workload with its existing resources. Should the proposal result in much additional workload on the IRD in future, the IRD will review the need and seek for additional resources, and the additional resources, if required, will be sought with justifications in accordance with established mechanism.

23. On financial implications, the proposal will give parity tax treatment to onshore and offshore funds. The majority of funds in Hong Kong are offshore ones, mainly because onshore funds cannot enjoy profits tax exemption under the current tax regimes. Offshore funds will continue to receive tax exemption under the proposed regime for funds. As such, the proposal should not give rise to significant tax revenue loss as compared to the current regimes. With the passage of the Bill, we expect to attract more funds to domicile and/or be managed in Hong Kong. That should drive demand for the related professional services (such as fund administration and investment advice, as well as legal, accounting and other ancillary services) locally. The services provided to tax-exempt funds will still be chargeable to profits tax.

24. On economic implications, the proposal should generate demand for professional services as explained in paragraph 23 above, in addition to sales and marketing of funds. This would help consolidate Hong Kong's role as a WAM centre and foster the further development of our financial services industry as a whole. Local start-ups would also benefit as the tax dis-incentive for funds to invest in local private companies has been removed.

## **PUBLIC CONSULTATION**

25. In April and May 2018, the Government conducted a four-week industry consultation on our preliminary proposal. The financial services industry understands the need to remove ring-fencing features but points out that the current tax treatment for offshore funds should be preserved as far as possible to avoid any inadvertent disruption to market operation. The proposal as set out in paragraphs 7 to 15 above has taken into account the industry's feedback.

26. We briefed the LegCo Panel on Financial Affairs on the proposal on 5 November 2018. Members were generally in support of our proposal.

## **ENQUIRIES**

27. Enquiries relating to this brief can be directed to Miss Carrie Chang, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services), at 2810 2054.

**Financial Services Branch  
Financial Services and the Treasury Bureau  
5 December 2018**

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

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## A BILL To

Amend the Inland Revenue Ordinance to allow profits tax exemption for certain funds whether or not the central management and control of the funds is exercised in Hong Kong; and to provide for related matters.

Enacted by the Legislative Council.

### 1. Short title and commencement

- (1) This Ordinance may be cited as the Inland Revenue (Profits Tax Exemption for Funds) (Amendment) Ordinance 2018.
- (2) This Ordinance comes into operation on 1 April 2019.

### 2. Inland Revenue Ordinance amended

The Inland Revenue Ordinance (Cap. 112) is amended as set out in sections 3 to 12.

### 3. Section 20AB amended (interpretation of sections 20AC, 20ACA, 20AD, 20AE, 20AF, 20AG, 20AH, 20AI, 20AJ, 20AK and 20AL and Schedules 15, 15A, 15B, 16A and 16B)

- (1) Section 20AB, heading—

#### Repeal

everything after “20AD,”

#### Substitute

“20AE and 20AF and Schedules 15, 15A and 16”.

- (2) Section 20AB(1)—

**Repeal**

“20AE, 20AF, 20AG, 20AH, 20AI, 20AJ, 20AK and 20AL and Schedules 15, 15A, 15B, 16A and 16B”

**Substitute**

“20AE and 20AF and Schedules 15, 15A and 16”.

**4. Section 20AC amended (certain profits of non-resident persons exempt from tax)**

After section 20AC(1)—

**Add**

“(1A) On and after 1 April 2019, a reference in this section to a non-resident person does not include a fund within the meaning of section 20AM.

(1B) Subsection (1A) applies only for any year of assessment commencing on or after 1 April 2019.”.

**5. Sections 20AG to 20AL repealed**

Sections 20AG, 20AH, 20AI, 20AJ, 20AK and 20AL—

**Repeal the sections.**

**6. Sections 20AM to 20AY added**

Before section 20B—

**Add**

**“20AM. What *fund* means in sections 20AN, 20AO, 20AP, 20AQ, 20AR, 20AS, 20AT, 20AU, 20AV, 20AW, 20AX and 20AY and Schedules 15C, 15D and 16C**

(1) In sections 20AN, 20AO, 20AP, 20AQ, 20AR, 20AS, 20AT, 20AU, 20AV, 20AW, 20AX and 20AY and

Schedules 15C, 15D and 16C, *fund* (基金) has the meaning given to it by this section.

- (2) An arrangement in respect of any property is a *fund* for a year of assessment if at all times during the basis period for the year of assessment—
- (a) either or both of the following apply—
- (i) under the arrangement, the property is managed as a whole by, or on behalf of, the person operating the arrangement;
- (ii) the contributions of the persons participating in the arrangement (*participating persons*), and the profits or income from which payment is made to them, are pooled under the arrangement;
- (b) under the arrangement, the participating persons do not have day-to-day control over the management of the property (whether or not they have the right to be consulted on, or to give directions in respect of, the management); and
- (c) the purpose or effect (or pretended purpose or effect) of the arrangement is to enable the participating persons, whether by acquiring any right, interest, title or benefit in the property or any part of the property or otherwise, to participate in or receive—
- (i) profits, income or other returns represented to arise (or to be likely to arise) from the acquisition, holding, management or disposal of the property (or any part of the property), or sums represented to be paid (or to be likely to be paid) out of any such profits, income or other returns; or

- (ii) a payment or other returns arising from the acquisition, holding or disposal of, the exercise of any right in, the redemption of, or the expiry of, any right, interest, title or benefit in the property or any part of the property.
- (3) In subsection (2)—  
*property* (財產) includes—
- (a) money, goods, choses in action and land (whether in Hong Kong or elsewhere); and
  - (b) obligations, easements and every description of estate, interest and profit, present or future, vested or contingent, arising out of or incidental to property mentioned in paragraph (a).
- (4) An arrangement (commonly known as a sovereign wealth fund) that is established and funded by a state or government (or any political subdivision or local authority of a state or government) for the purposes of—
- (a) carrying out financial activities; and
  - (b) holding and managing a pool of assets,
- for the benefit of the state or government (or the political subdivision or local authority) is also a *fund*.
- (5) A *fund* does not include an arrangement if—
- (a) the arrangement is operated by a person otherwise than by way of business;
  - (b) each of the persons participating in the arrangement (*participating persons*) is a corporation in the same group of companies as the operator of the arrangement;

- (c) each of the participating persons of the arrangement is—
- (i) a bona fide employee or former employee of a corporation in the same group of companies as the operator of the arrangement; or
  - (ii) a spouse, widow, widower, minor child (natural or adopted) or minor step-child of such employee or former employee;
- (d) the arrangement is a franchise arrangement under which the franchisor or franchisee earns profits or income by exploiting a right conferred by the arrangement to use a trade name or design or other intellectual property or goodwill attached to it;
- (e) money under the arrangement is taken by a solicitor (whether from his or her client or as a stakeholder) acting in his or her professional capacity in the ordinary course of practice;
- (f) the arrangement is made for the purposes of a fund or scheme maintained by—
- (i) the Securities and Futures Commission within the meaning of the Securities and Futures Ordinance (Cap. 571); or
  - (ii) a recognized exchange company, a recognized clearing house, a recognized exchange controller or a recognized investor compensation company, within the meaning of that Ordinance,
- under that Ordinance for providing compensation in the event of default by an exchange participant, or a clearing participant, within the meaning of that Ordinance;

- (g) the arrangement is made by a credit union registered under the Credit Unions Ordinance (Cap. 119) in accordance with the objects of the credit union;
  - (h) the arrangement is made for the purposes of any chit-fund permitted to operate under the Chit-Fund Businesses (Prohibition) Ordinance (Cap. 262); or
  - (i) the arrangement is a mutual fund, unit trust or similar investment scheme falling within the descriptions in section 26A(1A)(a)(i) and (ii).
- (6) Also, a business undertaking for general commercial or industrial purposes is not a *fund*.
- (7) In subsection (6), the reference to a business undertaking for general commercial or industrial purposes includes a business undertaking that directly engages in any one or more of the following—
- (a) a commercial activity that involves—
    - (i) any purchase, sale or exchange of goods or commodities; or
    - (ii) any supply of services;
  - (b) an industrial activity that involves any production of goods or construction of immovable property as defined by section 20AP(4);
  - (c) property development or property holding;
  - (d) finance, including—
    - (i) banking;
    - (ii) providing capital (other than providing capital to a special purpose entity, or an investee private company, as defined by section 20AO(4));

- (iii) leasing;
  - (iv) factoring;
  - (v) securitization; and
  - (vi) money-lending;
- (e) insurance business;
  - (f) construction or direct acquisition of infrastructure as defined by section 20AP(4);
  - (g) making direct investments that derive rent, royalties or lease payments.

**20AN. Certain profits of certain funds exempt from payment of profits tax**

- (1) This section applies subject to section 20AS.
- (2) If, in respect of a fund, a condition specified in subsection (3) is met at all times during the basis period for a year of assessment, the fund is, subject to sections 20AP and 20AQ, exempt from the payment of tax otherwise chargeable under this Part in respect of its assessable profits for the basis period earned from—
  - (a) transactions in assets of a class specified in Schedule 16C (*qualifying transactions*);
  - (b) subject to subsection (4), transactions incidental to the carrying out of qualifying transactions (*incidental transactions*); and
  - (c) if the fund is an open-ended fund company— transactions in assets of a class that is not specified in Schedule 16C.
- (3) The condition is—
  - (a) that the qualifying transactions of the fund are—

- (i) carried out in Hong Kong by or through a specified person; or
  - (ii) arranged in Hong Kong by a specified person; or
  - (b) that the fund is a qualified investment fund.
- (4) The exemption under subsection (2) does not apply to assessable profits earned from incidental transactions if the percentage calculated according to the following formula exceeds 5%—

$$A/B \times 100\%$$

where—

A = the fund's trading receipts from incidental transactions in the basis period;

B = the total of the fund's trading receipts from qualifying transactions and incidental transactions in the basis period.

- (5) The Commissioner may by notice published in the Gazette amend Schedule 16C.
- (6) In this section—

**aggregate capital commitment** (資本認繳總額), in relation to a qualified investment fund, means the total of the capital commitments made by the investors, the originator and the originator's associates;

**associate** (相聯者)—

- (a) in relation to a natural person, means—
  - (i) a relative of the person;
  - (ii) a partner of the person;
  - (iii) if a partner of the person is a natural person—a relative of the partner;

- (iv) a partnership in which the person is a partner;
  - (v) a corporation controlled by—
    - (A) the person;
    - (B) if the person is a natural person—a relative of the person;
    - (C) a partner of the person;
    - (D) if a partner of the person is a natural person—a relative of that partner; or
    - (E) a partnership in which the person is a partner; or
  - (vi) a director or principal officer of a corporation mentioned in subparagraph (v);
- (b) in relation to a corporation, means—
- (i) a person who controls the corporation;
  - (ii) a partner of the person mentioned in subparagraph (i);
  - (iii) if the person mentioned in subparagraph (i) is a natural person—a relative of the person;
  - (iv) if the partner mentioned in subparagraph (ii) is a natural person—a relative of the partner;
  - (v) a director or principal officer of—
    - (A) the corporation; or
    - (B) an associated corporation of the corporation;
  - (vi) a relative of the director or principal officer mentioned in subparagraph (v);
  - (vii) a partner of the corporation;

- (viii) if a partner of the corporation is a natural person—a relative of the partner;
- (ix) a partnership in which the corporation is a partner; or
- (x) an associated corporation of the corporation;
- (c) in relation to a partnership, means—
  - (i) a partner in the partnership;
  - (ii) if a partner in the partnership is a natural person—a relative of the partner;
  - (iii) if a partner in the partnership is another partnership—
    - (A) a partner in the other partnership (*Partner A*); or
    - (B) a partner with the other partnership in any other partnership (*Partner B*);
  - (iv) if Partner A is a partnership—a partner in Partner A (*Partner C*);
  - (v) if Partner B is a partnership—a partner in Partner B (*Partner D*);
  - (vi) if Partner A, Partner B, Partner C or Partner D is a natural person—a relative of the partner;
  - (vii) a corporation controlled by—
    - (A) the partnership;
    - (B) a partner in the partnership;
    - (C) if a partner in the partnership is a natural person—a relative of the partner; or
    - (D) a partnership in which the partnership is a partner;

- (viii) a director or principal officer of the corporation mentioned in subparagraph (vii);
- (ix) a corporation of which a partner in the partnership is a director or principal officer; or
- (x) an associated partnership of the partnership;

**associated corporation** (相聯法團), in relation to a corporation, means—

- (a) another corporation over which the corporation has control;
- (b) another corporation that has control over the corporation; or
- (c) another corporation that is under the control of the same person as is the corporation;

**associated partnership** (相聯合夥), in relation to a partnership, means—

- (a) another partnership over which the partnership has control;
- (b) another partnership that has control over the partnership; or
- (c) another partnership that is under the control of the same person as is the partnership;

**capital commitment** (資本認繳), in relation to a qualified investment fund, means a commitment—

- (a) in the form of an amount of money payable by an investor, the originator or the originator's associate to the fund under an agreement governing the operation of the fund; and

- (b) in respect of which the originator may make capital calls from time to time according to the terms of the agreement;

**control** (控制) —

- (a) in relation to a corporation, means the power of a person to secure—
- (i) by means of the holding of shares or the possession of voting power in or in relation to the corporation or any other corporation; or
  - (ii) by virtue of any powers conferred by the articles of association or other document regulating the corporation or any other corporation,

that the affairs of the corporation are conducted in accordance with the wishes of the person;

- (b) in relation to a partnership, means the power of a person to secure—
- (i) by means of the holding of interests or the possession of voting power in or in relation to the partnership or any other partnership; or
  - (ii) by virtue of any powers conferred by the partnership agreement or other document regulating the partnership or any other partnership,

that the affairs of the partnership are conducted in accordance with the wishes of the person;

**final closing of sale of interests** (權益出售最終截止日), in relation to a qualified investment fund, means the date on which the originator last accepts subscriptions from investors for making capital commitments;

**investor** (投資者), in relation to a qualified investment fund, means a person, other than the originator or the originator's associates, who makes capital commitment to the fund;

**net proceeds** (淨收益), in relation to a qualified investment fund at a particular time, means an amount calculated by—

- (a) adding together—
  - (i) the sum of the cumulative distributions received by the investors, the originator and the originator's associates from the fund by the particular time; and
  - (ii) the value at the particular time of all assets, if any, held by the fund; and
- (b) subtracting the cumulative capital contributions of the investors, the originator and the originator's associates by the particular time;

**originator** (發起人), in relation to a qualified investment fund, means a person who directly or indirectly—

- (a) originates or sponsors the fund; and
- (b) has the power to make investment decisions on behalf of the fund;

**principal officer** (主要職員), in relation to a corporation, means—

- (a) a person employed by the corporation who, either alone or jointly with one or more other persons, is responsible, under the immediate authority of the directors of the corporation, for the conduct of the business of the corporation; or

- (b) a person so employed who, under the immediate authority of a director of the corporation or a person to whom paragraph (a) applies, exercises managerial functions in respect of the corporation;

**qualified investment fund** (合資格投資基金) means a fund in relation to which—

- (a) at all times after the final closing of sale of interests—
- (i) the number of investors exceeds 4; and
  - (ii) the capital commitments made by investors exceed 90% of the aggregate capital commitments; and
- (b) an agreement governing the operation of the fund provides that not more than 30% of the net proceeds arising out of the transactions of the fund are to be received by the originator and the originator's associates, after deducting the portion attributable to their capital contributions (which is proportionate to that attributable to the investors' capital contributions);

**relative** (親屬), in relation to a person, means the spouse, parent, child, brother or sister of the person, and, in deducing such a relationship—

- (a) an adopted child is to be regarded as a child of both the natural parents and any adoptive parent; and
- (b) a step child is to be regarded as a child of both the natural parents and any step parent;

**specified person** (指明人士) means a corporation licensed under Part V of the Securities and Futures Ordinance (Cap. 571) to carry on, or an authorized financial institution registered under that Part for carrying on, a

business in any regulated activity as defined by Part 1 of Schedule 5 to that Ordinance.

- (7) Section 21 of Schedule 17A (specified alternative bond scheme and its tax treatment) provides for modifications to this section.

**20AO. Certain profits of special purpose entities exempt from payment of profits tax**

- (1) This section applies to a special purpose entity owned by a fund that is exempt from the payment of tax under section 20AN in respect of its assessable profits for a year of assessment.
- (2) The special purpose entity is, subject to sections 20AP and 20AQ, exempt to the extent provided by subsection (3) from the payment of tax chargeable under this Part in respect of its assessable profits for the year of assessment earned from—
  - (a) transactions in shares, stocks, debentures, loan stocks, funds, bonds or notes (*specified securities*) of, or issued by, an investee private company or an interposed special purpose entity;
  - (b) transactions in rights, options or interests (whether described as units or otherwise) in, or in respect of, the specified securities; and
  - (c) transactions in certificates of interest or participation in, temporary or interim certificates for, receipts for, or warrants to subscribe for or purchase, the specified securities.
- (3) The extent of exemption under subsection (2) is the percentage equal to the percentage of the fund's ownership of the special purpose entity in the year of assessment.

(4) In this section—

*interposed special purpose entity* (中間特定目的實體) means—

- (a) in relation to a special purpose entity that has an indirect beneficial interest in an investee private company through an interposed person that is a special purpose entity—the interposed person;
- (b) in relation to a special purpose entity that has an indirect beneficial interest in an investee private company through a series of 2 or more interposed persons each of which is a special purpose entity—any of the interposed persons;

*investee private company* (獲投資私人公司), in relation to a fund, means a private company held by a special purpose entity or an interposed special purpose entity as a shareholder on behalf of the fund;

*private company* (私人公司) means a company (whether incorporated in or outside Hong Kong) that is not allowed to issue any invitations to the public to subscribe for any shares or debentures of the company;

*special purpose entity* (特定目的實體) means a corporation, partnership, trustee of a trust estate or any other entity that—

- (a) is wholly or partially owned by a fund;
- (b) is established solely for the purpose of holding (whether directly or indirectly) and administering one or more investee private companies;
- (c) is incorporated, registered or appointed in or outside Hong Kong;
- (d) does not carry on any trade or activities except for the purpose of holding (whether directly or

indirectly) and administering one or more investee private companies; and

- (e) is not itself a fund or an investee private company.

**20AP. When does exemption under section 20AN or 20AO not apply to specified body holding immovable property through another company**

- (1) Subject to section 20AR, this section applies if, during the basis period for a year of assessment—
  - (a) a specified body carries out transactions in shares, stocks, debentures, loan stocks, funds, bonds or notes (*specified securities*) of, or issued by, a private company (*relevant company*); and
  - (b) the relevant company holds (whether directly or indirectly)—
    - (i) immovable property in Hong Kong; or
    - (ii) share capital (however described) in another private company that holds (whether directly or indirectly) immovable property in Hong Kong.
- (2) If the aggregate value of the immovable property and share capital held by the relevant company—
  - (a) exceeds 10% of the value of its assets—the specified body is not exempt from the payment of tax under this Part in respect of its assessable profits for the period earned from the transactions; or
  - (b) does not exceed 10% of the value of its assets—the specified body is not, unless a condition specified in subsection (3) is met in good faith by the specified body, exempt from the payment of tax

under this Part in respect of its assessable profits for the period earned from the transactions.

- (3) The condition is—
- (a) that the specified body disposes of, through a transaction or a series of transactions, the specified securities not less than 2 years after they are acquired (whether or not the specified body has control over the relevant company); or
  - (b) that the specified body disposes of, through a transaction or a series of transactions, the specified securities less than 2 years after they are acquired and—
    - (i) the specified body does not have control over the relevant company; or
    - (ii) if the specified body has control over the relevant company—the relevant company holds (whether directly or indirectly) short-term assets the aggregate value of which does not exceed 50% of the value of the relevant company's assets.

- (4) In this section—

*control* (控制) has the meaning given by section 20AN(6);

*immovable property* (不動產) means—

- (a) land (whether covered by water or not);
- (b) any estate, right, interest or easement in or over any land; and
- (c) things attached to land or permanently fastened to anything attached to land,

but does not include infrastructure;

*infrastructure* (基礎設施) means any publicly or privately owned facility providing or distributing services for the benefit of the public, and includes any water, sewage, energy, fuel, transportation or communication facility;

*private company* (私人公司) has the meaning given by section 20AO(4);

*short-term asset* (短期資產), in relation to a private company the shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, which are being disposed of by a fund, means an asset—

- (a) that is of a class not specified in Schedule 16C;
- (b) that is not immovable property in Hong Kong; and
- (c) that has been held by the company for less than 3 consecutive years before the date of disposal;

*special purpose entity* (特定目的實體) has the meaning given by section 20AO(4);

*specified body* (指明團體) means a fund or a special purpose entity.

**20AQ. When does exemption under section 20AN or 20AO not apply to specified body not holding immovable property through another company**

- (1) Subject to section 20AR, this section applies if, during the basis period for a year of assessment—
  - (a) a specified body carries out transactions in shares, stocks, debentures, loan stocks, funds, bonds or notes (*specified securities*) of, or issued by, a private company (*relevant company*); and
  - (b) the relevant company does not hold (whether directly or indirectly)—
    - (i) immovable property in Hong Kong; or

- (ii) share capital (however described) in another private company that holds (whether directly or indirectly) immovable property in Hong Kong.
- (2) The specified body is not, unless a condition specified in subsection (3) is met in good faith by the specified body, exempt from the payment of tax chargeable under this Part in respect of its assessable profits for the period earned from the transactions.
- (3) The condition is—
- (a) that the specified body disposes of, through a transaction or a series of transactions, the specified securities not less than 2 years after they are acquired (whether or not the specified body has control over the relevant company); or
- (b) that the specified body disposes of, through a transaction or a series of transactions, the specified securities less than 2 years after they are acquired and—
- (i) the specified body does not have control over the relevant company; or
- (ii) if the specified body has control over the relevant company—the relevant company holds (whether directly or indirectly) short-term assets the aggregate value of which does not exceed 50% of the value of the relevant company's assets.
- (4) In this section—
- control* (控制) has the meaning given by section 20AN(6);
- immovable property* (不動產) has the meaning given by section 20AP(4);

- private company* (私人公司) has the meaning given by section 20AO(4);
- short-term asset* (短期資產) has the meaning given by section 20AP(4);
- special purpose entity* (特定目的實體) has the meaning given by section 20AO(4);
- specified body* (指明團體) has the meaning given by section 20AP(4).

#### 20AR. Supplementary provision to sections 20AP and 20AQ

- (1) Sections 20AP and 20AQ do not apply to a partner fund carrying on a trade, profession or business that involves transactions in shares of an investee company during the basis period for a year of assessment.
- (2) In this section—
- investee company* (獲投資公司) means—
- (a) a corporation that has ITVFC and a partner fund as shareholders under the ITVF Scheme; or
- (b) a corporation that—
- (i) had, at any time, ITVFC and a partner fund (*Fund A*) as shareholders under the ITVF Scheme; and
- (ii) has, since that time, continued to have a partner fund (whether *Fund A* or another partner fund) as a shareholder;

*ITVF Scheme* (創基計劃) means the Innovation and Technology Venture Fund Scheme established by the Innovation and Technology Commission;

**ITVFC** (創基公司) means The Innovation and Technology Venture Fund Corporation incorporated under the Companies Ordinance (Cap. 622);

**partner fund** (夥伴基金) means a fund that is a party (whether or not through an agent) to an agreement—

- (a) to which ITVFC is also a party;
- (b) that stipulates the overall rights and obligations of ITVFC and the fund in respect of their participation in the ITVF Scheme; and
- (c) that is valid and in force.

**20AS. When does exemption under section 20AN not apply to open-ended fund companies**

Despite section 20AN, if, during the basis period for a year of assessment, an open-ended fund company—

- (a) carries on a direct trading or direct business undertaking in Hong Kong in assets of a class that is not specified in Schedule 16C (*non-Schedule 16C class*); or
- (b) holds assets of a non-Schedule 16C class that are utilized to generate income,

the company is not exempt from the payment of tax chargeable under this Part in respect of its assessable profits for the basis period earned from the trading, business undertaking or utilization.

**20AT. Sub-funds of open-ended fund companies**

- (1) This section applies in relation to an open-ended fund company.
- (2) If the instrument of incorporation of the company (*main company*) provides for the division of its scheme

property into separate parts (each of which is a *sub-fund*), then, when applying section 14 to the main company—

- (a) a reference to assessable profits in that section is a reference to the total of the assessable profits of all of its sub-funds; and
- (b) for computing the assessable profits of the sub-funds—
  - (i) each sub-fund is to be regarded as an open-ended fund company;
  - (ii) the main company is to be regarded as not being an open-ended fund company; and
  - (iii) the provisions of this Part apply to a sub-fund as if it were an open-ended fund company.

- (3) The part of the profits tax chargeable on the main company that is attributable to the assessable profits of one of the sub-funds may only be paid out of the assets of the sub-fund.
- (4) If the condition for exemption from payment of tax under section 20AN is met in respect of a sub-fund, the sub-fund is exempt under that section even if the condition is not met in respect of another sub-fund of the main company.
- (5) Any loss sustained by a sub-fund is not available for set off against any assessable profits of another sub-fund of the main company.
- (6) In this section—

**scheme property** (計劃財產) has the meaning given by section 112A of the Securities and Futures Ordinance (Cap. 571).

**20AU. Losses sustained by funds (other than open-ended fund companies) and special purpose entities**

- (1) This section applies in relation to a fund (other than an open-ended fund company) and a special purpose entity.
- (2) If a fund is exempt from the payment of tax under section 20AN in respect of its assessable profits for a year of assessment, any loss sustained by the fund from a transaction referred to in section 20AN(2)(a) or (b) in the year of assessment is not available for set off against any of its assessable profits for the year of assessment or any subsequent year of assessment.
- (3) If a special purpose entity is exempt from the payment of tax under section 20AO in respect of its assessable profits for a year of assessment, any loss sustained by the entity from a transaction referred to in section 20AO(2) in the year of assessment is not available for set off against any of its assessable profits for the year of assessment or any subsequent year of assessment.
- (4) In this section—  
*special purpose entity* (特定目的實體) has the meaning given by section 20AO(4).

**20AV. Losses sustained by open-ended fund companies**

- (1) This section applies in relation to an open-ended fund company.
- (2) If the company is exempt from the payment of tax under section 20AN in respect of its assessable profits for a year of assessment, any loss sustained by the company from a transaction referred to in section 20AN(2)(a), (b) or (c) in the year of assessment is not available for set off against any of its assessable profits for the year of assessment or any subsequent year of assessment.

- (3) Any loss sustained by the company from a specified activity in respect of which there is not an exemption from the payment of tax for assessable profits under section 20AN or 20AS for a year of assessment is only available for set off against any assessable profits of the company earned from the specified activity for the year of assessment or any subsequent year of assessment.

- (4) In this section—

*specified activity* (指明活動) means a transaction, a direct trading, a direct business undertaking or utilization of assets.

**20AW. Interpretation of sections 20AX and 20AY and Schedules 15C and 15D**

- (1) This section applies to the interpretation of sections 20AX and 20AY and Schedules 15C and 15D.
- (2) In relation to any year of assessment, a person is to be regarded as a resident person if—
  - (a) where the person is a natural person who is not a trustee of a trust estate, the person—
    - (i) ordinarily resides in Hong Kong in the year of assessment; or
    - (ii) stays in Hong Kong for a period or a number of periods amounting to—
      - (A) more than 180 days during the year of assessment; or
      - (B) more than 300 days in 2 consecutive years of assessment one of which is the year of assessment;
  - (b) where the person is a corporation that is not a trustee of a trust estate—the central management

- and control of the corporation is exercised in Hong Kong in the year of assessment;
- (c) where the person is a partnership that is not a trustee of a trust estate—the central management and control of the partnership is exercised in Hong Kong in the year of assessment; or
- (d) where the person is a trustee of a trust estate—the central management and control of the trust estate is exercised in Hong Kong in the year of assessment.
- (3) In relation to any year of assessment, a person is a non-resident person if the person is not a resident person in relation to the year of assessment.
- (4) A person (*the person*) is to be regarded as having a direct beneficial interest in another person (*the other person*) if—
- (a) where the other person is a corporation that is not a trustee of a trust estate—the person holds any of the issued share capital (however described) of the corporation;
- (b) where the other person is a partnership that is not a trustee of a trust estate—the person, as a partner in the partnership, is entitled to any of the profits of the partnership;
- (c) where the other person is a trustee of a trust estate, the person—
- (i) benefits under the trust estate; or
- (ii) not being a trustee of the trust estate or, if the trustee is a corporation, a director of the trustee—is able (or might reasonably be expected to be able) to control the activities

- of the trust estate or the application of its corpus or income,
- otherwise than through the other person; or
- (d) where the other person is an entity that does not fall within any of paragraphs (a), (b) and (c)—the person has any of the ownership interests in the entity.
- (5) A person (*the person*) is to be regarded as having an indirect beneficial interest in another person (*the other person*) if—
- (a) where the other person is a corporation that is not a trustee of a trust estate—the person is interested in any of the issued share capital (however described) of the corporation;
- (b) where the other person is a partnership that is not a trustee of a trust estate—the person is entitled to any of the profits of the partnership;
- (c) where the other person is a trustee of a trust estate, the person—
- (i) benefits under the trust estate; or
- (ii) not being a trustee of the trust estate or, if the trustee is a corporation, a director of the trustee—is able (or might reasonably be expected to be able) to control the activities of the trust estate or the application of its corpus or income; or
- (d) where the other person is an entity that does not fall within any of paragraphs (a), (b) and (c)—the person has any of the ownership interests in the entity,

through a third person (*interposed person*), or through a series of 2 or more interposed persons, who is or are related to the person and the other person in the way described in subsections (6) and (7).

- (6) If there is one interposed person—
- (a) the person has a direct beneficial interest in the interposed person; and
  - (b) the interposed person has a direct beneficial interest in the other person.
- (7) If there is a series of 2 or more interposed persons—
- (a) the person has a direct beneficial interest in the first interposed person in the series;
  - (b) each interposed person (other than the last interposed person) in the series has a direct beneficial interest in the next interposed person in the series; and
  - (c) the last interposed person in the series has a direct beneficial interest in the other person.
- (8) If the partners in a partnership are not entitled to its profits but are only entitled to a distribution of its assets on its dissolution—a reference to an entitlement to the profits of a partnership is taken to be a reference to an entitlement to a distribution of the assets of the partnership on its dissolution.
- (9) A reference to the issued share capital of a corporation does not include the shares comprised in the issued share capital that do not entitle their holders to receive dividends (whether in cash or in kind) and a distribution of the corporation's assets on its dissolution other than a return of capital.

**20AX. Assessable profits of funds regarded as assessable profits of resident persons**

- (1) If, in a year of assessment commencing on or after 1 April 2019—
- (a) a resident person has, during any period of time, a beneficial interest (whether direct or indirect or both) in a fund to the extent set out in subsection (2); and
  - (b) the fund is exempt from the payment of tax under section 20AN,
- the assessable profits of the fund for the period of time that would have been chargeable to tax under this Part but for that section are to be regarded as the assessable profits arising in, or derived from, Hong Kong of the resident person for the year of assessment from a trade, profession or business carried on by the resident person in Hong Kong.
- (2) The extent of a resident person's beneficial interest in a fund referred to in subsection (1) is that the person, either alone or jointly with any of the person's associates (whether a resident person or not)—
- (a) if the fund is a corporation that is not a trustee of a trust estate—holds or is interested in not less than 30% of the issued share capital (however described) of the corporation;
  - (b) if the fund is a partnership that is not a trustee of a trust estate—is entitled to not less than 30% of the profits of the partnership;
  - (c) if the fund is a trustee of a trust estate—is interested in not less than 30% in value of the trust estate; or

- (d) if the fund is an entity that does not fall within any of paragraphs (a), (b) and (c)—has not less than 30% of the ownership interests in the fund.
- (3) If, in a year of assessment commencing on or after 1 April 2019—
- (a) a resident person has, during any period of time, a beneficial interest (whether direct or indirect or both) in a fund;
- (b) the fund is exempt from the payment of tax under section 20AN; and
- (c) the fund is an associate of the resident person, the assessable profits of the fund for the period of time that would have been chargeable to tax under this Part but for that section are to be regarded as the assessable profits arising in, or derived from, Hong Kong of the resident person for the year of assessment from a trade, profession or business carried on by the resident person in Hong Kong.
- (4) Subsections (1) and (3) apply in relation to a resident person irrespective of whether the person has received or will receive (whether directly or indirectly) from the fund concerned any money or other property representing the profits of the fund for the relevant year of assessment.
- (5) A resident person who has a direct or indirect beneficial interest in a trustee of a trust estate because of the fact that the resident person is able (or might reasonably be expected to be able) to control the activities of the trust estate or the application of its corpus or income is, for the purposes of this section, to be regarded as being interested in 100% of the value of the trust estate.

- (6) The extent of a resident person's beneficial interest in a fund is to be determined in accordance with Part 2 of Schedule 15C.
- (7) The amount regarded as the assessable profits of a resident person for a year of assessment under subsection (1) or (3) is to be ascertained in accordance with Schedule 15C.
- (8) Subsections (1) and (3) do not apply in relation to a resident person who has a direct or indirect beneficial interest in a fund if the Commissioner is satisfied that the beneficial interests in the fund are bona fide widely held.
- (9) If—
- (a) a resident person is liable to tax in respect of the profits of a fund by the operation of subsection (1) or (3) because the person has an indirect beneficial interest in the fund through an interposed person (or through a series of 2 or more interposed persons); and
- (b) the interposed person (or any of the interposed persons) is a resident person who is also liable to tax in respect of the profits by the operation of subsection (1) or (3),
- the resident person mentioned in paragraph (a) is discharged from the person's liability to tax in respect of the profits.
- (10) In this section—
- associate* (相聯者) has the meaning given by section 20AN(6).

**20AY. Assessable profits of special purpose entities held by funds regarded as assessable profits of resident persons**

- (1) If, in a year of assessment commencing on or after 1 April 2019—
- (a) a resident person has, during any period of time, a beneficial interest (whether direct or indirect or both) in a fund to the extent set out in section 20AX(2);
  - (b) the fund is exempt from the payment of tax under section 20AN;
  - (c) the fund has, during the period of time, a beneficial interest (whether direct or indirect or both) in a special purpose entity; and
  - (d) the special purpose entity is exempt from the payment of tax under section 20AO,
- the assessable profits of the special purpose entity for the period of time that are chargeable to tax under this Part and in respect of which tax would have been payable but for section 20AO are to be regarded as the assessable profits arising in, or derived from, Hong Kong of the resident person for the year of assessment from a trade, profession or business carried on by the resident person in Hong Kong.
- (2) If, in a year of assessment commencing on or after 1 April 2019—
- (a) a resident person has, during any period of time, a beneficial interest (whether direct or indirect or both) in a fund;
  - (b) the fund is exempt from the payment of tax under section 20AN;
  - (c) the fund is an associate of the resident person;

- (d) the fund has, during the period of time, a beneficial interest (whether direct or indirect or both) in a special purpose entity; and
  - (e) the special purpose entity is exempt from the payment of tax under section 20AO,
- the assessable profits of the special purpose entity for the period of time that are chargeable to tax under this Part and in respect of which tax would have been payable but for section 20AO are to be regarded as the assessable profits arising in, or derived from, Hong Kong of the resident person for the year of assessment from a trade, profession or business carried on by the resident person in Hong Kong.
- (3) Subsections (1) and (2) apply in relation to a resident person irrespective of whether the person has received or will receive (whether directly or indirectly) from the special purpose entity concerned any money or other property representing the profits of the special purpose entity for the relevant year of assessment.
  - (4) A resident person who has a direct or indirect beneficial interest in a trustee of a trust estate because of the fact that the resident person is able (or might reasonably be expected to be able) to control the activities of the trust estate or the application of its corpus or income is, for the purposes of this section, to be regarded as being interested in 100% of the value of the trust estate.
  - (5) The extent of a fund's beneficial interest in a special purpose entity is to be determined in accordance with Part 2 of Schedule 15D.
  - (6) The amount regarded as the assessable profits of a resident person for a year of assessment under

subsection (1) or (2) is to be ascertained in accordance with Schedule 15D.

(7) Subsections (1) and (2) do not apply in relation to a resident person who has a direct or indirect beneficial interest in a fund if the Commissioner is satisfied that the beneficial interests in the fund are bona fide widely held.

(8) If—

(a) a resident person is liable to tax in respect of the profits of a special purpose entity by the operation of subsection (1) or (2) because the person has an indirect beneficial interest in the special purpose entity through an interposed person (or through a series of 2 or more interposed persons); and

(b) the interposed person (or any of the interposed persons) is a resident person who is also liable to tax in respect of the profits by the operation of subsection (1) or (2),

the resident person mentioned in paragraph (a) is discharged from the person’s liability to tax in respect of the profits.

(9) In this section—

*associate* (相聯者) has the meaning given by section 20AN(6);

*special purpose entity* (特定目的實體) has the meaning given by section 20AO(4).”.

**7. Schedule 15B repealed (provisions for ascertaining amount of assessable profits of resident person under section 20AK)**

Schedule 15B—

**Repeal the Schedule.**

**8. Schedules 15C and 15D added**

Before Schedule 16—

**Add**

**“Schedule 15C**

[ss. 20AM, 20AW &  
20AX & Sch. 15D]

**Provisions for Ascertaining Amount of Assessable Profits of Resident Person under Section 20AX**

**Part 1**

1. The amount regarded as the assessable profits of a resident person for a year of assessment is the total sum arrived at by adding up the assessable profits of the fund that are chargeable to tax under Part 4 and in respect of which tax would have been payable but for section 20AN (*exempt profits*) for each day in the period in the year of assessment during which the resident person has a direct or indirect beneficial interest in the fund.

2. For the purposes of section 1 of this Part, the exempt profits of a fund for a particular day in a year of assessment are to be ascertained in accordance with the following formula—

$$A = \frac{B \times C}{D}$$

where: A means the exempt profits of the fund for a particular day in a year of assessment;

- B means the extent of the resident person's beneficial interest in the fund on the particular day, expressed as a percentage determined in accordance with Part 2 of this Schedule;
- C means the exempt profits of the fund for the accounting period of the fund in which the particular day falls;
- D means the total number of days in the accounting period of the fund in which the particular day falls.

## Part 2

1. For a resident person having a direct beneficial interest in a fund, the extent of the beneficial interest of the resident person in the fund is—
  - (a) if the fund is a corporation that is not a trustee of a trust estate—the percentage of the issued share capital (however described) of the corporation held by the resident person;
  - (b) if the fund is a partnership that is not a trustee of a trust estate—the percentage of the profits of the partnership to which the resident person is entitled;
  - (c) if the fund is a trustee of a trust estate—the percentage in value of the trust estate in which the resident person is interested; or
  - (d) if the fund is an entity that does not fall within any of paragraphs (a), (b) and (c)—the percentage of ownership interests that the resident person has in the entity.

2. For a resident person having an indirect beneficial interest in a fund, the extent of the beneficial interest of the resident person in the fund is—
  - (a) if there is only one interposed person—the percentage arrived at by multiplying the percentage representing the extent of the beneficial interest of the resident person in the interposed person by the percentage representing the extent of the beneficial interest of the interposed person in the fund; or
  - (b) if there is a series of 2 or more interposed persons—the percentage arrived at by multiplying the percentage representing the extent of the beneficial interest of the resident person in the first interposed person in the series by—
    - (i) the percentage representing the extent of the beneficial interest of each interposed person (other than the last interposed person) in the series in the next interposed person in the series; and
    - (ii) the percentage representing the extent of the beneficial interest of the last interposed person in the series in the fund.
3. For the purposes of section 2 of this Part—
  - (a) section 1 of this Part applies in determining the extent of the beneficial interest of a resident person in an interposed person as if the references to a fund in that section were references to an interposed person;
  - (b) section 1 of this Part applies in determining the extent of the beneficial interest of an interposed person in a fund as if the references to a resident

- person in that section were references to an interposed person; and
- (c) section 1 of this Part applies in determining the extent of the beneficial interest of an interposed person (*Interposed Person A*) in another interposed person (*Interposed Person B*) as if—
- (i) the references to a resident person in that section were references to Interposed Person A; and
- (ii) the references to a fund in that section were references to Interposed Person B.

### Schedule 15D

[ss. 20AM, 20AW &  
20AY]

## Provisions for Ascertaining Amount of Assessable Profits of Resident Person under Section 20AY

### Part 1

1. The amount regarded as the assessable profits of a resident person for a year of assessment is the total sum arrived at by adding up the assessable profits of the special purpose entity that are chargeable to tax under Part 4 and in respect of which tax would have been payable but for section 20AO (*exempt profits*) for each day in the period in the year of assessment

- during which the resident person has an indirect beneficial interest in the special purpose entity.
2. For the purposes of section 1 of this Part, the exempt profits of a special purpose entity for a particular day in a year of assessment are to be ascertained in accordance with the following formula—

$$A = \frac{B1 \times B2 \times C}{D}$$

- where: A means the exempt profits of the special purpose entity for a particular day in a year of assessment;
- B1 means the extent of the resident person's beneficial interest in the fund on the particular day, expressed as a percentage determined in accordance with Part 2 of Schedule 15C;
- B2 means the extent of the fund's beneficial interest in the special purpose entity on the particular day, expressed as a percentage determined in accordance with Part 2 of this Schedule;
- C means the exempt profits of the special purpose entity for the accounting period of the special purpose entity in which the particular day falls;
- D means the total number of days in the accounting period of the special purpose entity in which the particular day falls.

3. In this Part—

*special purpose entity* (特定目的實體) has the meaning given by section 20AO(4).

## Part 2

1. For a fund having a direct beneficial interest in a special purpose entity, the extent of the beneficial interest of the fund in the special purpose entity is—
  - (a) if the special purpose entity is a corporation that is not a trustee of a trust estate—the percentage of the issued share capital (however described) of the corporation held by the fund;
  - (b) if the special purpose entity is a partnership that is not a trustee of a trust estate—the percentage of the profits of the partnership to which the fund is entitled;
  - (c) if the special purpose entity is a trustee of a trust estate—the percentage in value of the trust estate in which the fund is interested; or
  - (d) if the special purpose entity is an entity that does not fall within any of paragraphs (a), (b) and (c)—the percentage of ownership interests that the fund has in the entity.
2. For a fund having an indirect beneficial interest in a special purpose entity, the extent of the beneficial interest of the fund in the special purpose entity is—
  - (a) if there is only one interposed person—the percentage arrived at by multiplying the percentage representing the extent of the beneficial interest of the fund in the interposed person by the percentage representing the extent of the beneficial interest of

the interposed person in the special purpose entity; or

- (b) if there is a series of 2 or more interposed persons—the percentage arrived at by multiplying the percentage representing the extent of the beneficial interest of the fund in the first interposed person in the series by—
  - (i) the percentage representing the extent of the beneficial interest of each interposed person (other than the last interposed person) in the series in the next interposed person in the series; and
  - (ii) the percentage representing the extent of the beneficial interest of the last interposed person in the series in the special purpose entity.
3. For the purposes of section 2 of this Part—
  - (a) section 1 of this Part applies in determining the extent of the beneficial interest of a fund in an interposed person as if the references to a special purpose entity in that section were references to an interposed person;
  - (b) section 1 of this Part applies in determining the extent of the beneficial interest of an interposed person in a special purpose entity as if the references to a fund in that section were references to an interposed person; and
  - (c) section 1 of this Part applies in determining the extent of the beneficial interest of an interposed person (*Interposed Person A*) in another interposed person (*Interposed Person B*) as if—

- (i) the references to a fund in that section were references to Interposed Person A; and
- (ii) the references to a special purpose entity in that section were references to Interposed Person B.

## 4. In this Part—

*special purpose entity* (特定目的實體) has the meaning given by section 20AO(4).”.

9. **Schedule 16 amended (specified transactions)**

Schedule 16—

**Repeal**

“[s. 20AC”

**Substitute**

“[ss. 20AB &amp; 20AC”.

10. **Schedules 16A and 16B repealed**

Schedules 16A and 16B—

**Repeal the Schedules.**11. **Schedule 16C added**

Before Schedule 17—

**Add****“Schedule 16C**

[ss. 20AM, 20AN, 20AP  
& 20AS & Sch. 17A]

## Classes of Assets Specified for Transactions for Purposes of Section 20AN

### Part 1

1. Securities
2. Shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, a private company
3. Futures contracts
4. Foreign exchange contracts under which the parties to the contracts agree to exchange different currencies on a particular date
5. Deposits other than those made by way of a money-lending business
6. Deposits (as defined by section 2(1) of the Banking Ordinance (Cap. 155)) made with a bank (as defined by Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571))
7. Certificates of deposit (as defined by Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571))
8. Exchange-traded commodities
9. Foreign currencies
10. OTC derivative products (as defined by Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571))

11. An investee company's shares co-invested by a partner fund and ITVFC under the ITVF Scheme

## Part 2

1. In this Schedule—

*collective investment scheme* (集體投資計劃) means an arrangement in respect of any property—

- (a) under which either or both of the following apply—
- (i) the property is managed as a whole by, or on behalf of, the person operating the arrangement;
  - (ii) the contributions of the persons participating in the arrangement (*participating persons*) and the profits or income from which payments are made to them are pooled;
- (b) under which the participating persons do not have day-to-day control over the management of the property (whether or not they have the right to be consulted on, or to give directions in respect of, the management); and
- (c) the purpose or effect (or pretended purpose or effect) of which is to enable the participating persons (whether by acquiring any right, interest, title or benefit in the property or any part of the property or otherwise) to participate in or receive—
- (i) profits, income or other returns represented to arise (or to be likely to arise) from the acquisition, holding, management or disposal of the property (or any part of the property),

or sums represented to be paid (or to be likely to be paid) out of any such profits, income or other returns; or

- (ii) a payment or other returns arising from the acquisition, holding or disposal of, the exercise of any right in, the redemption of, or the expiry of, any right, interest, title or benefit in the property (or any part of the property);

*contract for differences* (差價合約) means an agreement the purpose or effect of which is to obtain a profit or avoid a loss by reference to fluctuations in the value or price of property of any description or in an index or other factor designated for that purpose in the agreement;

*debenture* (債權證) includes debenture stocks, bonds, and other debt securities of a corporation (whether constituting a charge on the assets of the corporation or not);

*deposit* (存款) means a loan of money—

- (a) at interest; or
- (b) repayable at a premium or repayable with any consideration in money or money's worth;

*exchange-traded commodity* (交易所買賣商品) 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 that Ordinance;

*futures contract* (期貨合約) means—

- (a) a contract or an option on a contract made under the rules or convention of a futures market; or
- (b) any other contract for differences—

- (i) that is listed on a specified stock exchange, or traded on a specified futures exchange, within the meaning of section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571);
- (ii) that an authorized institution within the meaning of the Banking Ordinance (Cap. 155) may enter into under that Ordinance; or
- (iii) the transaction in respect of which is regulated by or under, or is carried out in compliance with, the Securities and Futures Ordinance (Cap. 571);

*futures market* (期貨市場) has the meaning given by section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571);

*investee company* (獲投資公司) has the meaning given by section 20AR(2);

*ITVF Scheme* (創基計劃) has the meaning given by section 20AR(2);

*ITVFC* (創基公司) has the meaning given by section 20AR(2);

*partner fund* (夥伴基金) has the meaning given by section 20AR(2);

*private company* (私人公司) has the meaning given by section 20AO(4);

*property* (財產) has the meaning given by section 20AM(3);

*securities* (證券) means—

- (a) subject to section 21(6) of Schedule 17A (specified alternative bond scheme and its tax treatment), shares, stocks, debentures, loan stocks, funds,

bonds or notes of, or issued by, a body (including a special purpose entity), whether incorporated or unincorporated, or a government or municipal government authority;

- (b) rights, options or interests (whether described as units or otherwise) in, or in respect of, such shares, stocks, debentures, loan stocks, funds, bonds or notes;
- (c) certificates of interest or participation in, temporary or interim certificates for, receipts for, or warrants to subscribe for or purchase, such shares, stocks, debentures, loan stocks, funds, bonds or notes;
- (d) interests in any collective investment scheme;
- (e) interests, rights or property (whether in the form of an instrument or otherwise) commonly known as securities; or
- (f) a structured product in respect of which the issue of any advertisement, invitation or document that is or contains an invitation to the public to do any act referred to in section 103(1)(a) of the Securities and Futures Ordinance (Cap. 571) is authorized, or required to be authorized, under section 105(1) of that Ordinance;

*share* (股份) means any share in the share capital of a corporation, and, except where a distinction between stock and shares is express or implied, includes stock;

*special purpose entity* (特定目的實體) has the meaning given by section 20AO(4).”

12. **Schedule 17A amended (specified alternative bond scheme and its tax treatment)**

(1) Schedule 17A—

**Repeal**

“26A(2) & (4), 40AB, 51C(5), 60(4), 64(11), 79(4), 80(6) & 82A(8) & Schs. 6, 16”

**Substitute**

“20AN(7), 26A(2) & (4), 40AB, 51C(5), 60(4), 64(11), 79(4), 80(6) & 82A(8) & Schs. 6, 16, 16C”.

(2) Schedule 17A, section 21(6)—

**Repeal**

“Section 20AC”

**Substitute**

“Sections 20AC and 20AN”.

(3) Schedule 17A, section 21(6)—

**Repeal**

“Schedule 16”

**Substitute**

“Schedules 16 and 16C”.

(4) Schedule 17A, section 21(6)—

**Repeal**

“that Schedule”

**Substitute**

“those Schedules”.

**Explanatory Memorandum**

The objects of this Bill are to amend the Inland Revenue Ordinance (Cap. 112) (*Ordinance*) to allow profits tax exemption for certain funds whether or not the central management and control of the funds is exercised in Hong Kong, and to provide for related matters.

2. Clause 1 sets out the short title and provides for commencement.
3. Clause 3 amends section 20AB of the Ordinance to update certain references.
4. Clause 4 amends section 20AC of the Ordinance to provide that, on and after 1 April 2019, a reference in the section to a non-resident person does not include a fund within the meaning of the new section 20AM.
5. Clause 5 repeals sections 20AG, 20AH, 20AI, 20AJ, 20AK and 20AL of the Ordinance to align the profits tax treatment for open-ended fund companies with other funds.
6. Clause 6 adds new sections 20AM, 20AN, 20AO, 20AP, 20AQ, 20AR, 20AS, 20AT, 20AU, 20AV, 20AW, 20AX and 20AY to the Ordinance.
7. The new section 20AM gives the meaning of *fund* for the purposes of certain provisions of the Ordinance. The meaning of *fund* is similar (with necessary modifications) to that of *collective investment scheme* set out in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) (*SFO*).
8. The new section 20AN exempts certain funds from paying profits tax on their assessable profits in relation to certain transactions if certain conditions are met.
9. The new section 20AO exempts special purpose entities from paying profits tax on their assessable profits in relation to certain transactions. A special purpose entity is a legal entity that is wholly

- or partly owned by a fund. If the fund is exempted under the new section 20AN, the special purpose entity is also exempted to the extent that corresponds to the percentage of shares or interests that the fund holds in the entity.
10. The new sections 20AP and 20AQ deal with when an exemption under the new section 20AN or 20AO does not apply to funds and special purpose entities. If a fund or special purpose entity (*specified body*) carries out transactions in shares, stocks, debentures, loan stocks, funds, bonds or notes (*specified securities*) of, or issued by, a private company, the following factors all contribute to the end result of whether an exemption under the new section 20AN or 20AO is to be available to the specified body—
    - (a) the company holding or not holding (whether directly or indirectly) immovable property;
    - (b) the period of the company's specified securities being held by the specified body;
    - (c) the specified body having or not having control over the company; and
    - (d) the level of short-term assets held by the company.
  11. The new section 20AR provides that the new sections 20AP and 20AQ do not apply to a partner fund that is a party under an agreement to which The Innovation and Technology Venture Fund Corporation is also a party.
  12. The new section 20AS deals with when an exemption under the new section 20AN does not apply to an open-ended fund company.
  13. The new section 20AT provides that if the instrument of incorporation of an open-ended fund company provides for the division of its scheme property (as defined by section 112A of the SFO) into separate parts (each of which is a *sub-fund*), then each sub-fund is to be regarded an open-ended fund company for computing the assessable profits of the sub-fund.

14. The new sections 20AU and 20AV set out the circumstances under which the losses sustained by funds and special purpose entities from certain transactions are available, or not available, for set off against their assessable profits.
15. The new section 20AW is an interpretation provision for the new sections 20AX and 20AY and the new Schedules 15C and 15D.
16. The new sections 20AX and 20AY set out the circumstances under which the assessable profits of a fund or special purpose entity are to be regarded as the assessable profits of a resident person if the resident person has a beneficial interest in the fund or special purpose entity.
17. Clause 7 repeals Schedule 15B to the Ordinance to align the profits tax treatment for open-ended fund companies with other funds.
18. Clause 8 adds new Schedules 15C and 15D to the Ordinance. The 2 new Schedules provide for how the amounts of assessable profits of resident persons are to be ascertained under the new sections 20AX and 20AY respectively.
19. Clause 9 amends Schedule 16 to the Ordinance to update a reference.
20. Clause 10 repeals Schedules 16A and 16B to the Ordinance to align the profits tax treatment for open-ended fund companies with other funds.
21. Clause 11 adds a new Schedule 16C to the Ordinance. The new Schedule 16C sets out the classes of assets specified for the transactions for the purposes of the new section 20AN.
22. Clause 12 amends Schedule 17A to the Ordinance to update certain references.

**Tests on profits tax exemption eligibility for profits generated from transactions in private companies by funds**

