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

By email (renitaau@fstb.gov.hk) and by hand

11 May 2018

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Financial Services Branch
Financial Services and the Treasury Bureau
Central Government Offices
2 Tim Mei Avenue
Tamar
Hong Kong

Attention: Ms Renita Au

Dear Sirs,

Proposals to remove ring-fencing features from the tax regimes for funds

Thank you for inviting the views of the Hong Kong Institute of Certified Public Accountants ("the Institute") on the paper, "Proposals to Remove Ring-Fencing Features from the Tax Regimes for Funds" ("the Paper"). The Tax Faculty ("TF") of the Hong Kong Institute of Certified Public Accountants ("Institute") has reviewed the proposals and understands the objective of addressing the concerns of the international tax community, in particular the European Union, about aspects of the Hong Kong's tax treatment of funds. While, in general, the TF supports the proposed removal of the "ring-fencing" features of the existing tax concessions, there are also concerns about some of the proposals set out in the Paper. Our views and concerns are summarised below.

1. Definition of "fund"

Given that the stated purpose of the proposals is to remove ring-fencing features under the existing tax regime for offshore funds and offshore private equity funds (thus providing tax exemption to privately offered funds, regardless of fund structure or the location of their central management and control ("CMC")), the proposals should not seek to narrow down eligibility for the tax exemption regime.

The proposals indicate that "fund" will be defined to cover all types of funds, irrespective of their CMC location, mainly adopting the definition of "collective investment scheme" in Schedule 1 to the Securities and Futures Ordinance, with suitable modifications, as opposed to "non-resident person" (i.e., an offshore fund), as defined in the existing Inland Revenue Ordinance ("IRO"). It needs to be ensured, therefore, that all funds currently eligible for profits tax exemption will continue to be eligible under the new definition.

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2. ***Fund size requirement***

We agree with the proposal that there should be no fund size requirement for the purpose of seeking tax exemption, as stated in paragraph 9 of the Paper.

3. ***Eligible assets***

We agree with retaining the present eligible asset classes. However, we note that there are some differences in the wording of Schedule16 (specified transactions in relation to offshore funds) of the IRO and the new Schedule 16A (classes of assets specified in relation to onshore privately offered open-ended fund companies ("OFCs")), added by the Inland Revenue (Amendment) (No.2) Ordinance 2018. We suggest that the legislation to implement the current proposals should aim to ensure consistency as far as possible and to adopt the least restrictive variation of similar terms. For example, item 5 of Schedule 16A refers to:

Deposits (as defined in section 2(1) of the Banking Ordinance (Cap. 155)) made with a bank (as defined in Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571)),

while item 4 of Part 1 of Schedule 16 refers to:

a transaction consisting in the making of a deposit other than by way of a money-lending business.

4. ***Interest in private companies***

We consider that the proposed holding period requirement of at least 5 years, indicated in subparagraph (b) of paragraph 12 of the Paper, is too long. We would suggest that, if a minimum holding period is required, a period of 12 months or 24 months (which we understand to be the holding period required under the exemption regime in Singapore) would be more appropriate.

5. ***Carried interest taxation***

We consider that the proposal to deem dividends from tax-exempt funds to be taxable in the hands of investment managers, to the extent that they are regarded as consideration or remuneration for services rendered in Hong Kong, may not be appropriate. As mentioned above, the stated purpose of the proposals is to remove the ring-fencing features of the existing tax exemption regime for funds and the issue of carried interest is not such a feature. While we note the reference in footnote 10 of the Paper to the existing provision under section 20AJ(3), applicable to privately offered onshore OTCs, the appropriateness of this tax treatment has been questioned by the fund industry and tax practitioners. We would suggest, therefore, that rather than replicating this provision, the

government should take a more holistic approach to addressing the issue and conduct further consultation with the fund industry, as well as looking into the tax treatment of carried interest in other jurisdictions.

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

Yours faithfully,

Peter Tisman
Director, Advocacy & Practice Development

PMT/EKC/rc