



Tax Newsflash

Hong Kong Tax News: Open-ended Fund Company legislation progressing



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德勤百年庆 开创新纪元

A bill (Inland Revenue (Amendment) (No. 4) Bill 2017 (Bill)) that would extend the exemption from Hong Kong profits tax to onshore privately offered open-ended fund companies (OFCs) was gazetted on 23 June 2017 and presented to the Legislative Council for a first reading on 28 June 2017. The proposed exemption, announced during the 2017/18 budget speech delivered by the Financial Secretary on 22 February 2017, is designed to promote the asset management industry in Hong Kong, diversify the industry and enhance Hong Kong's position as an international asset management center. The initiative generally has been broadly welcomed.

An OFC is an open-ended collective investment scheme with variable capital set up in the form of a company that will allow flexibility in their share capital and cancellation of shares in order to meet investors subscription and redemption requests.

A legal framework for the establishment and regulation of OFC structures was enacted in June 2016 (Securities and Futures (Amendment) Ordinance 2016). The Securities and Futures Commission (SFC) and relevant government bodies now are expected to prepare subsidiary legislation that will set out the necessary rules for the operation and relevant procedures for the OFC regime, with a view to implementing the regime in the second quarter of 2018.

However, the mere existence of a legislative regime for OFCs is not a sufficient incentive for funds to locate in Hong Kong—parity of tax treatment also is an important consideration. Under current law, an exemption from profits tax is granted

only to (i) publicly offered funds authorized by the SFC or an equivalent overseas regulatory body; and (ii) offshore funds (whether or not they are publicly offered). This treatment results in tax disparity on onshore privately offered OFCs since they will be subject to Hong Kong profits tax on their Hong Kong-source trading profits, while onshore publicly offered OFCs and offshore OFCs generally will be exempt from profits tax.

To address this differential tax treatment, the Bill provides that an onshore privately offered OFC would be exempt from profits tax from qualifying transactions and transactions incidental to the carrying out of qualifying transactions (up to 5% of total trading receipts), provided all of the following conditions are fulfilled:

- The OFC is a resident of Hong Kong, i.e. its central management and control are exercised in Hong Kong;
- The OFC is not closely held (as defined with respect to the minimum/maximum number of investors and participating interests in the relevant legislation);
- The OFC carries out transactions in "permissible asset classes" as specified by the SFC (i.e. mainly securities and futures). It may invest in non-permitted asset classes up to a maximum of 10% of its total gross asset value; and
- The transactions are carried out through or arranged by a "qualified person" (i.e. SFC Type 9 (asset management) license holder) in Hong Kong.

The Bill contains anti-abuse measures, in particular "deeming provisions" that target "round-tripping" by a resident person disguised as an onshore privately offered OFC through a direct or an indirect beneficial interest in the onshore privately offered OFC to take advantage of the profits tax exemption. The deeming provisions would be triggered if the resident person holds (i) 30% or more of the beneficial interest in the onshore privately offered OFC; or (ii) any percentage of the beneficial interest if the resident person is an "associate" of the onshore privately offered OFC. In such a case, the relevant portion of the onshore privately offered OFC's assessable profits will be deemed taxable in the hands of the resident person. The operation of the deeming provision is fundamentally the same as the provision under the existing offshore fund tax exemption regime.

The Bill clarifies that each sub-fund of an OFC would be assessed separately for the purpose of the tax exemption.

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