



Brussels, 14 March 2019
(OR. en)

7470/19

FISC 179

OUTCOME OF PROCEEDINGS

From: General Secretariat of the Council
To: Code of Conduct Group (Business Taxation)
Subject: Hong Kong's Offshore Funds regime (HK002)
– Final description and assessment

ROLLBACK REVIEW PROCESS (FEBRUARY 2019)

On 20 February 2019, Hong Kong adopted the Bill that amends this regime. The new legislation will enter into force on 1 April 2019.

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

<https://www.legco.gov.hk/yr18-19/english/bills/b201812072.pdf>

<https://www.info.gov.hk/gia/general/201902/20/P2019022000649.htm>

Hong Kong has removed the ring-fencing features by opening the regime to all funds (both on- and offshore) and all type of investment (removal of the condition that investment had to be made in companies incorporated overseas). There is an exception concerning immovable property: if a fund invests in a private company that holds, directly or indirectly, more than 10% of its assets in immovable property (excluding infrastructure) in Hong Kong, the fund will be taxed on the profits arising from such an investment in the private company. However, given that the ring-fencing features have been removed for all other types of income, this last feature should not be regarded as detrimental. The Bill does not mention grandfathering.

The Code of Conduct Group meeting of 27 February 2019 approved the rollback of the regime. This conclusion was endorsed by the ECOFIN Council on 12 March 2019.

Annex 1: Assessment of the old HK002 regime in 2017 (standstill review)

Assessment of the old HK002 regime in 2017 (standstill)

Category:

- Exempt and Offshore Companies

a. Description of the regime

If an offshore fund derives trading profits from securities transactions carried out through an agent i.e. its broker in Hong Kong, the activities of the onshore agent can be attributed to the offshore fund. And if those activities amount to the carrying on of a business in Hong Kong, profits of the fund from those trades could be subject to tax.

A non-resident person (including corporations and partnerships) is not be subject to tax on profits derived from

(i) “specified transactions” that were

(ii) carried out in Hong Kong through or arranged by a “specified person”.

Additionally, to qualify for the exemption, the non-resident person must not carry on any business in Hong Kong in addition to the specified transactions, except for a limited scope of transactions which were incidental to the carrying out of the specified transactions. Any onshore non-qualifying transactions would cause the tainting of all specified transactions of the offshore fund that would otherwise have qualified for the exemption for that year of assessment.

The scope of the 2006 Exemption largely confines its use to the activities of offshore hedge funds and does not address transactions typically carried out by private equity funds when investing in or through Hong Kong. The principal issues are these:

“Specified transactions” included transactions in “securities”, but specifically excluded the shares of private companies. This largely rules out the availability of the exemption for the types of investments typically structured by private equity funds.

“Specified person” means a licensed corporation under Hong Kong’s licensing regime, which is administered by the Securities and Futures Commission. Typically, the onshore advisors of many offshore private equity funds are not licensed as either their activities fall outside of the scope of the regime, or they are able to claim an available exemption, and private equity funds might not typically execute their transaction through a licensed person.

The 2006 Exemption includes anti-avoidance provisions that would attribute offshore profits to an onshore resident person who triggered a 30% ownership test in the offshore person.

Sources: [PWC](#), [EMPEA](#)

b. Preferential:

This regime can be qualified as preferential as offshore funds are exempt from CIT.

c. Possible concern:

There is a risk of ring-fencing because the exemption is only applicable to offshore funds who may not carry on any business in Hong Kong in addition to the specified transactions.

The OECD also mentioned this regime and stated it is possibly ring-fenced.

d. Assessment :

	1a	1b	2a	2b	3	4	5
Hong Kong – Offshore Funds Regime (HK002)	V	V	V	X	X	X	X

V = harmful

X = not harmful

The regime in question is an exemption which therefore effectively applies a zero rate to certain profits and is prima facie preferential as it provides for a significantly lower level of taxation.

The regime is only available to non-residents which appears to fall foul of criteria 1 and 2.

