



Brussels, 15 March 2019
(OR. en)

7516/19

FISC 181

OUTCOME OF PROCEEDINGS

From: General Secretariat of the Council
To: Code of Conduct Group (Business Taxation)
Subject: Hong Kong's Offshore Private Equity regime (HK003)
– 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 HK003 regime in 2017 (standstill review)

Assessment of the old HK003 regime in 2017 (standstill)

Category:

- Exempt and Offshore Companies

a. Description

On 17 July, 2015 Hong Kong enacted legislation to expand the existing offshore funds tax exemption to benefit non resident private equity funds. The change applies to transactions occurring on or after 1 April, 2015.

The 2015 Amendment expands the scope of the 2006 Exemption to include the assessable profits of an onshore special purpose vehicle (“SPV”) owned by a non-resident person (the fund), derived from the disposal of the shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, an offshore portfolio company which is a private company. The activities of the SPV in Hong Kong must be limited to holding and administering one or more offshore portfolio companies which are private companies (so-called an “excepted private company” (“EPC”)).

An added requirement introduced by the 2015 Amendment for the exemption to apply is that the offshore fund must be a “qualifying fund”. This is an alternative to the existing requirement of the 2006 Exemption that the transaction be carried out through a “specified person” and is in recognition of the position that many PE funds may not require an SFC licensed corporation to carry out their transactions. These criteria for a “qualifying fund” are that:

- at all times after the final closing of sale of interests (i) there are at least 5 investors in the fund, and (ii) the capital commitments made by investors exceed 90% of the aggregate capital commitments; and
- the portion of the net proceeds arising out of the transactions of the fund to be received by the originator (i.e. sponsor) 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), is agreed under a fund’s governing documents to be an amount not exceeding 30% of the net proceeds.

Whether a fund, structured as a corporation or partnership, qualifies as a non-resident person will be determined by whether the fund’s central management and control was exercised outside of Hong Kong in the year of assessment in question. The phrase “central management and control” is not defined in legislation but is a well-established judicially developed principle that refers to the highest level of control of the business of a company.

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

b. Preferential:

The regime can be qualified as preferential as non-resident private equity funds are exempt from CIT.

c. Possible concern:

There is a risk of ring-fencing because the exemption is applicable only for non-resident private equity funds.

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 (HK003)	V	V	V	X	X	X	X

V = harmful

X = not harmful

The regime in question is an extension of the exemption discussed above. It 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.
