

## Hong Kong passes new legislation to grant profits tax exemption to all privately-offered funds

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### Executive summary

Hong Kong's Legislative Council passed, on 20 February 2019, the bill (the Bill) for new legislation (the New Law) to grant the profits tax exemption to all privately-offered funds. The New Law will be effective for transactions occurring on or after 1 April 2019.

The Bill retains the original form without any amendment.<sup>1</sup>

In addition, the Hong Kong Government clarified certain provisions of the New Law during the legislative process.

### Detailed discussion

#### Overview

Under the New Law, regardless of residence, all privately-offered funds in the form of collective investment funds will be exempt from profits tax in Hong Kong on their usual investment and securities trading income, provided that the transactions are carried out by a specified person, or the fund itself is a qualifying fund.

A fund or a special purpose entity (SPE) will be exempt from tax on its profits arising from sale of private company shares (irrespective of the country of its incorporation) subject to satisfying certain additional conditions.

The New Law does not include any tainting provisions; accordingly, disqualifying transactions do not make nontaxable profits of a fund or an SPE subject to tax.

The current tax exemption regime for the non-fund entities will remain unchanged.

### **Clarification by the Government**

#### **A bona fide fund may only have one investor at a certain point of time**

Under the New Law, one of the necessary conditions for qualifying as a “fund” is that the arrangement involved must pool the contributions of persons (participating persons) participating in the arrangement.

However, the Government has clarified that the term “participating persons” would not necessarily prevent a bona fide fund from enjoying the tax exemption, even though it only has one investor at a certain point in time (e.g., at the initial stage of launching a fund).

#### **No relaxation of what an SPE can perform**

The New Law limits the scope of activities of an SPE to holding and administering investee private companies, which prompted requests that the Government relax the scope of activities.

However, the Government rejected the requests and maintained its view that an SPE should be established solely for the purpose of holding and administering investee private companies.

#### **The term “met in good faith”**

The New Law taxes profits derived from the disposal of private companies unless specified conditions are met by a fund or an SPE “in good faith.” However, the term “in good faith” is not defined in the New Law.

The Government expressed that the Inland Revenue Department will take into consideration all relevant factors in determining whether a fund or an SPE is acting in good faith.

#### **“Holding of debt securities to earn interest” is not a qualifying transaction**

Under the New Law, qualifying transactions do not include “the holding of debentures, loan stocks, bonds or notes to earn interest income.”

Requests were made that the Government include these activities as qualifying transactions; however, the requests were not accepted.

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### **Endnote**

1. See EY Global Tax Alert, [Hong Kong proposes to remove ring-fencing features of current exemption regime for privately-offered funds](#), dated 18 December 2018.

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