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# Second Consultation Paper on Exemption of Offshore Funds from Hong Kong profits tax

The Hong Kong Financial Services and Treasury Bureau have issued a second consultation paper on the proposed exemption of offshore funds from Hong Kong profits tax.

Currently, only funds that are authorised by the Securities and Futures Commission or those that are widely held and regulated overseas are exempt from profits tax in Hong Kong. The potential exposure of other funds depends on their operational structure in Hong Kong.

In January 2004, the Financial Services and Treasury Bureau issued the first consultation paper on exemption of offshore funds from Hong Kong profits tax. The paper proposed to grant the exemption only to offshore funds that were at least 80% beneficially owned by non-resident investors. The fund's brokers and investment advisers would be required to keep sufficient records to verify the non-resident status of each of the investors claiming the exemption and that the 80% exemption threshold had not been breached.

In response to the consultation paper, the industry raised concerns about the heavy compliance burden placed on brokers/investment advisers and the difficulties faced in ascertaining the residence status of the ultimate beneficial owners. Acknowledging these concerns, the Financial Services and Treasury Bureau issued a second consultation paper in December 2004.

Under the revised approach, the 80% threshold has been removed. New Exemption Provisions grant exemption from profits tax to the non-resident fund without regard to the composition of its beneficial owners. Profits qualified for exemption are profits derived from Hong Kong through securities trading transactions carried out through exempted section 20AA brokers or investment advisors (i.e. brokers or investment advisors who are not associates of the offshore fund and, in the case of an investment advisor, are acting in an independent capacity). The non-resident fund may not carry on any other business in Hong Kong. Offshore profits and capital gains will remain non-taxable.

Under new Deeming Provisions introduced in the second consultation paper, Hong Kong resident investors may be taxed on Hong Kong-sourced securities trading profits of exempted offshore funds, irrespective of whether profits are distributed to investors or not. The Deeming Provisions would apply to:

1. residents who, together with their resident and non-resident associates, hold a certain minimum percentage (30% in the consultation paper) in a fund; or
2. residents holding any percentage whatsoever in a fund where the fund and the resident are associates.

Interested parties have until 31 January 2005 to submit comments on the second consultation paper.

*This note is a summary only of the second consultation paper issued by the Financial Services and Treasury Bureau. The full text of the consultation paper is available on the Bureau's website*

2013-10-17 Link Update - [consultation paper](http://www.fstb.gov.hk/fsb/ppr/consult/doc/eof-e.pdf) - [consultation conclusions](http://www.fstb.gov.hk/fsb/ppr/consult/doc/eof_conclu_e.pdf)

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