

LEGISLATIVE COUNCIL BRIEF

Inland Revenue Ordinance
(Chapter 112)

Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Bill 2021

INTRODUCTION

At the meeting of the Executive Council on 26 January 2021, the Council **ADVISED** and the Chief Executive **ORDERED** that the Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Bill 2021 (“the Bill”), at **Annex A**, should be introduced into the Legislative Council (“LegCo”) to provide tax concessions for carried interest distributed by eligible private equity (“PE”) funds operating in Hong Kong.

A

JUSTIFICATIONS

Development of Hong Kong’s PE Industry

2. PE fund is a collective investment scheme with its underlying assets primarily consisting of equity securities of private companies¹ that are not publicly traded on a stock exchange. In recent years, PE funds (including venture capital funds) are gaining popularity amongst investors and have become a key impetus to the growth of asset and wealth management business. PE funds play a pivotal role in channelling capital, talents and expertise into corporations, in particular start-ups in

¹ There are different investment strategies for PE funds. PE funds typically invest in private companies and may exit through trade sale or initial public offering. Some PE funds would take private a listed company, increase the value of the company acquired through various strategies such as implementing a growth plan, restructuring the company, introducing new processes and technologies that will improve the operational efficiency and productivity of the company, and exit by going public in another stock exchange. Generally, the entire process takes several years.

the innovation and technology sector. In 2019, Hong Kong ranked second in Asia after the Mainland in terms of the total capital under management by PE funds (excluding real estate funds), which amounted to US\$161 billion².

3. Given Hong Kong's active initial public offering market for PE-backed companies and our proximity to the Mainland which offers a stream of deal flow, Hong Kong is a viable domicile for PE funds. Over the past few years, the Government has spared no efforts in developing Hong Kong as a premier PE fund hub, including the establishment of a limited partnership fund regime to meet the operational needs of PE funds which commenced operation on 31 August 2020³. Moreover, since 1 April 2019, privately-offered funds, including PE funds, are exempted from the payment of profits tax in respect of assessable profits derived from eligible transactions in local and overseas private companies, subject to meeting the relevant exemption conditions.

4. On the taxation of the service provider of a PE fund, a typical PE fund pays, broadly speaking, the following remuneration –

- (a) an annual management fee at a specified percentage of the fund's assets under management under an investment management agreement; and
- (b) a return linked to the performance of an investment (described as "carried interest") typically upon the disposal of the investment after it has been held for a period of time and subject to a hurdle rate⁴.

Management fee and carried interest, if derived from investment management services rendered in Hong Kong, will be chargeable service income for profits tax or chargeable employment income for salaries tax (as the case may be).

² Source: Asian Venture Capital Journal.

³ 70 limited partnership funds have been set up in Hong Kong as at 5 January 2021.

⁴ Broadly speaking, carried interest will generally be distributed subject to the return from the investments of the fund meeting certain hurdle rate. Hurdle rate means a preferred rate of return on investments in the fund which is stipulated in the agreement for governing the operation of the fund.

5. Given that tax treatment is one of the key factors influencing the choice of jurisdiction for fund domiciliation and operations, it is announced in the 2020-21 Budget Speech that we plan to provide tax concessions for carried interest issued by PE funds operating in Hong Kong, subject to the fulfilment of certain conditions, with a view to attracting more PE funds to operate in Hong Kong, and boosting more investment management and related activities which will create business opportunities in related professional services and bring economic benefits to Hong Kong.

THE PROPOSAL

6. A task force, led by the Financial Services and the Treasury Bureau (“FSTB”) and comprising members from the Inland Revenue Department (“IRD”), Hong Kong Monetary Authority (“HKMA”) and Securities and Futures Commission, has examined how tax concessions could be applied to carried interest distributed by PE funds. An industry consultation was conducted from August to September 2020 to gauge the industry’s views. Having considered the comments received, the proposed parameters and eligibility criteria for the tax concession regime for carried interest are summarised in the ensuing paragraphs.

Eligible Carried Interest

7. In order to differentiate carried interest from other types of management fee / remuneration received by investment professionals, we propose to define “eligible carried interest” as a sum received by, or accrued to, a person by way of a profit-related return subject to a hurdle rate which is a preferred rate of return on investments in the fund which is stipulated in the agreement governing the operation of the fund. The term “profit-related return” encompasses three conditions –

- (a) the eligible carried interest arises only if there are profits for a period on the investments, or on particular investments, made for the purposes of the certified investment fund concerned (see paragraph 8 below), or there are profits arising from a disposal of the investment of the fund;

- (b) the eligible carried interest paid would vary by reference to the profits⁵; and
- (c) the returns to external investors are also determined by reference to the same profits.

Qualifying Carried Interest Payer

8. We propose that tax concessions would only apply to eligible carried interest distributed by a fund which falls within the meaning of “fund” under section 20AM of the Inland Revenue Ordinance (Cap. 112) (“the Ordinance”). The fund must be certified by the HKMA (“certified investment fund”) (as detailed in paragraphs 15 and 16 below) and, in the case of a non-resident fund, an authorised local representative must be appointed, who will be responsible for providing the necessary particulars and information to the IRD and the HKMA on behalf of the fund.

9. Separately, under the Innovation and Technology Venture Fund launched by the Innovation and Technology Commission, The Innovation and Technology Venture Fund Corporation (“the ITVF Corporation”) would co-invest with selected venture capital funds as co-investment partners in eligible local innovation and technology start-ups and pay a return to its co-investment partners (and investment managers), amounting to 35% of the realised capital gain upon the sale of the ITVF Corporation’s shares in the start-ups. The nature of this return is similar to that of carried interest. In this connection, we therefore propose that the ITVF Corporation can be included as a qualifying carried interest payer and the return distributed by the ITVF Corporation will be eligible for tax concessions under the tax concession regime for carried interest.

Qualifying Transactions of Certified Investment Funds

10. In line with our policy objective to promote the development of PE funds in Hong Kong, concessionary tax treatment would be ring-fenced to eligible carried interest arising from qualifying transactions

⁵ If there is no significant risk that a sum of at least a certain amount would not be received by, or accrued to, the person concerned, the said amount is not regarded as “carried interest”. Section 809EYC(3)(b) of the Income Tax Act 2007 of the United Kingdom provides the “no significant risk” condition which aims to catch management fees disguised as carried interest, i.e. sums which are in substance virtually certain to arise.

in PE only. We propose that, for tax concessions to apply, eligible carried interest must arise from transactions⁶ –

- (a) in shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, a private company specified under Schedule 16C to the Ordinance;
- (b) in shares of, or comparable interests in a special purpose entity or an interposed special purpose entity which is solely holding (whether directly or indirectly) and administering one or more investee private companies;
- (c) in shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, an investee private company held by a special purpose entity or an interposed special purpose entity at paragraph 10(b) above; or
- (d) incidental to the carrying out of the qualifying transactions at paragraphs 10(a) to (c) above⁷.

Moreover, in order to prevent tax abuse, the qualifying transactions have to meet all the relevant tax exemption conditions under the profits tax regime for privately offered funds under sections 20AM to 20AY of the Ordinance before the eligible carried interest arising from the transactions concerned is eligible for tax concessions.

Qualifying Carried Interest Recipients

11. We propose that the following persons providing investment management services (as defined in paragraph 12 below) to a certified investment fund or the ITVF Corporation in Hong Kong, or arranging such services to be carried out in Hong Kong, should be eligible for the concessionary tax treatment –

⁶ Depending on the facts and circumstances of each case, carried interest derived from hedging transaction may be eligible for tax concessions if the hedging transaction would form part and parcel of the PE transaction and the profits on the hedging transaction are embedded in the profits or loss on the PE transaction for the calculation of carried interest.

⁷ As provided under section 20AN(4) of the Ordinance, the trading receipts from incidental transactions shall not exceed 5% of the total trading receipts from qualifying transactions and incidental transactions.

- (a) a corporation licensed under Part V of the Securities and Futures Ordinance (Cap. 571) (“SFO”) or an authorised financial institution registered under that Part for carrying on a business in any regulated activity as defined in Part 1 of Schedule 5 to the SFO;
- (b) a person⁸, who does not fall within paragraph 11(a) above, providing investment management services in Hong Kong to a certified investment fund which is a “qualified investment fund”⁹ or the ITVF Corporation, or arranging such services to be carried out in Hong Kong; and
- (c) an individual deriving assessable income from the employment with the qualifying persons referred to in paragraph 11(a) or (b) above or their associated corporation or associated partnership¹⁰ by providing investment management services in Hong Kong to the certified investment funds or the ITVF Corporation on behalf of the qualifying persons.

Provision of Investment Management Services

12. We propose that, to be eligible for the concessionary tax treatment, the eligible carried interest must be derived from the provision of investment management services in Hong Kong to a certified investment fund or the ITVF Corporation. The investment management services must be provided in Hong Kong in view of the policy objective to attract more PE funds to operate in Hong Kong. Such services include –

- (a) seeking funds for the certified investment fund from external investors or potential external investors;

⁸ Including a natural person, corporation, partnership, trustee, whether incorporated or unincorporated, or body of persons.

⁹ A “qualified investment fund” is defined under section 20AN(6) of the Ordinance as a fund with at least five investors and meeting certain requirements over capital commitments and distribution of the net proceeds.

¹⁰ If the individual is employed by the associated corporation or associated partnership of the qualifying person, the associated corporation or associated partnership shall carry on a business in Hong Kong.

- (b) researching and advising on potential investments to be made for the certified investment fund or the ITVF Corporation;
- (c) acquiring, managing or disposing of property or investments for the certified investment fund or the ITVF Corporation; and
- (d) acting for the certified investment fund with a view to assisting an entity in which the fund has made an investment to raise funds.

Substantial Activities Requirements

13. Our proposal shall be in compliance with the Organisation for Economic Cooperation and Development (“OECD”)’s latest international taxation standards, including the anti-Base Erosion and Profit Shifting (“BEPS”) measures. In determining whether a preferential tax regime meets the international standards on counteracting BEPS, the OECD will take into account whether the regime can meet the substantial activities requirements to ensure that those beneficiaries of the preferential tax regime would undertake core income generating activities in the jurisdiction providing the regime.

14. We propose that, in order for concessionary tax treatment to apply, qualifying carried interest recipients at paragraph 11(a) or (b) above must have, in the opinion of the Commissioner of Inland Revenue, adequate number of qualified full-time employees and operating expenditure incurred in Hong Kong for the relevant years of assessment¹¹, including –

- (a) the average number of full-time employees in Hong Kong who carry out the investment management services as set out in paragraphs 12(a) to (d) above during the basis period for each year of assessment concerned shall be two or more; and
- (b) the total amount of operating expenditure incurred in Hong Kong for the provision of the investment management services

¹¹ Covering the period beginning on the day on which the carried interest recipient begins to carry out investment management services directly or indirectly for the certified investment fund or the ITVF Corporation and ending on the day on which eligible carried interest is received by, or accrued to, the carried interest recipient.

as set out in paragraphs 12(a) to (d) above during the basis period for each year of assessment concerned shall be HK\$2 million or more.

The HKMA's Certification and On-going Monitoring Mechanism

15. To prevent tax abuse, the HKMA will administer a certification scheme administratively and funds¹² will have to go through a certification process before concessionary tax treatment will apply to their eligible carried interest distributions. To apply for certification, a fund or the local authorised representative of a non-resident fund should submit an application to the HKMA, together with relevant documents and information as required by the HKMA. The HKMA will assess, based on the information provided, whether the fund makes PE investment and whether the local employment and local spending requirements of the carried interest recipients are likely to be met. A letter of certification will be issued by the HKMA if it is satisfied that the relevant criteria are met.

16. In a particular year of assessment where there is a distribution of eligible carried interest, an external auditor should be engaged to verify that the relevant substantial activities requirements imposed on the carried interest recipients are met in the relevant years of assessment, and that the distribution fulfils the conditions under the tax concession regime. The auditor's report should be kept at the fund's local office or with the local authorised representative of a non-resident fund for inspection if needed. The IRD may seek advice from the HKMA in order to ascertain whether, among others, a service constitutes investment management service, a sum may be eligible carried interest and an entity is a certified investment fund. In addition, the qualifying carried interest recipients and certified investment fund shall provide information to the Commissioner of Inland Revenue in relation to the distribution of eligible carried interest and keep sufficient records.

Deduction of Expenses and Loss Not Available for Set Off

17. For qualifying carried interest recipients subject to profits tax (i.e. qualifying carried interest recipients at paragraph 11(a) or (b) above),

¹² The intention is to cover PE funds with different investment strategies so long as they are genuine investment funds, except for the ITVF Corporation established by the Government.

we propose that only the net eligible carried interest after deducting any outgoings and expenses and depreciation would be eligible for the tax concessions. Also, any loss sustained is not available for set off against any of the assessable profits of the qualifying carried interest recipient for the year or any subsequent year of assessment if the concessionary tax rate is zero.

Anti-avoidance Provisions

18. To prevent tax abuse, if the Commissioner of Inland Revenue is satisfied that the main purpose, or one of the main purposes, of a person entering into an arrangement is to obtain a tax benefit, the concessionary tax treatment would not apply to the person concerned. Moreover, we will specify in the legislation that management fee (even if disguised as eligible carried interest) received by, or accrued to, qualifying carried interest recipients would not be eligible for tax concessions.

Concessionary Tax Rate

19. We propose that eligible carried interest would be charged at profits tax rate of 0%, while 100% of eligible carried interest would be excluded from the employment income for the calculation of salaries tax. The proposal would enhance our competitiveness in attracting PE funds to set up and be managed in Hong Kong.

OTHER MATTERS

Relaxation of Investment Scope for Special Purpose Entities

20. In addition to the proposed tax concession regime for carried interest, we propose to make certain enhancements to the profits tax regime for privately offered funds in order to facilitate the operation of funds in Hong Kong. At present, it is common for funds to hold financial assets other than private companies using special purpose entities (“SPEs”) established by the fund. However, an SPE, as currently defined under the Ordinance, is only allowed to hold and administer investee private companies, but not other financial assets. To address the sector’s concerns, we propose to –

- (a) allow an SPE to hold and administer assets of a class specified in Schedule 16C to the Ordinance; and
- (b) allow an SPE to carry out transactions in such assets on behalf of the fund.

Application of the Proposed Tax Concession Regime for Carried Interest

21. The Bill will apply concessionary tax treatment to eligible carried interest received by, or accrued to, qualifying carried interest recipients on or after 1 April 2020. This would provide tax certainty and facilitate the early decision of PE funds to domicile and operate in Hong Kong.

OTHER OPTIONS

22. We must amend the Ordinance to provide tax concessions for carried interest. There is no other option.

THE BILL

23. The main provisions of the Bill are as follows –
- (a) Clause 5 amends section 19CA¹³ of the Ordinance to amend the definitions of *chargeable concessionary trading receipts*, *concession provision* and *unabsorbed loss in respect of the concessionary trading receipts*, so that those definitions may apply in relation to the new Schedule 16D;
 - (b) Clauses 6 and 7 expand for the purposes of profits tax exemption the eligible classes of assets that may be held and administered by an SPE on behalf of a fund that owns the SPE (paragraph 20 above refers);

¹³ As amended by section 7 of the Inland Revenue (Amendment) (Profits Tax Concessions for Insurance-related Businesses) Ordinance 2020 (Ord. 15 of 2020).

- (c) Clause 8 adds Part 6B to the Ordinance to introduce the carried interest tax concession regime and to empower the Secretary for Financial Services and the Treasury to amend certain provisions of the new Schedule 16D by notice published in the Gazette, having regard to future developments in international tax standards;
- (d) Clauses 9 and 10 apply the record-keeping and provision of information requirements, and relevant penalties, under the Ordinance, to qualifying persons under the tax concession regime;
- (e) Clause 11 consequentially amends Schedule 16C to include references to section 20AO and the new Schedule 16D;
- (f) Clause 12 introduces the new Schedule 16D to the Ordinance, which contains the following parts –
 - (i) Part 1 of the new Schedule 16D provides for definitions of *associated corporation, associated partnership, certified investment fund, control, disposal of investment, eligible carried interest, entity, external investor, investment management services, profit-related return, qualifying employee, qualifying payer, qualifying person, specified entity*; and *sum*;
 - (ii) Part 2 of the new Schedule 16D contains provisions on profits tax treatment of eligible carried interest for a qualifying person (within the meaning of section 4(3) of that Schedule), including provisions setting out the conditions to be satisfied, the transactions that give rise to the eligible carried interest and the calculation and the rate of profits tax in respect of eligible carried interest. In that Part, the profits tax rate is set at 0%;
 - (iii) Part 3 of the new Schedule 16D contains provisions on salaries tax treatment of eligible carried interest for a qualifying employee (as defined by section 8(4) of that Schedule), including provisions setting out the conditions to be satisfied by the employee, the calculation of the employee's salaries tax assessable income and the percentage of eligible carried interest to be excluded for

salaries tax calculation. In that Part, the percentage is set at 100%;

- (iv) Part 4 of the new Schedule 16D contains provisions on the obligations of a qualifying person (section 10 of that Schedule) and qualifying payer (section 11 of that Schedule) in relation to provision of information and retention of records;
- (v) Part 5 of the new Schedule 16D contains provisions to enable the Commissioner of Inland Revenue to seek advice from the Monetary Authority on certain matters in the event of a claim, provisions to prevent tax avoidance relating to arrangement to obtain tax benefit, and provisions to prevent set-off of certain losses sustained by qualifying persons against their assessable profits;
- (vi) Part 6 of the new Schedule 16D provides that the tax treatment of eligible carried interest in that Schedule applies in relation to eligible carried interest received by, or accrued to, a qualifying person or a qualifying employee on or after 1 April 2020.

LEGISLATIVE TIMETABLE

24. The legislative timetable will be –

Publication in the Gazette	29 January 2021
First Reading and commencement of Second Reading debate	3 February 2021
Resumption of Second Reading debate, committee stage and Third Reading	To be notified

COMMENCEMENT

25. The Bill commences on the day on which the amendment ordinance is gazetted after it is enacted by LegCo.

IMPLICATIONS OF THE PROPOSAL

26. The Bill is in conformity with the Basic Law, including the provisions concerning human rights. It will not affect the current binding effect of the existing provisions of the Ordinance. There are no productivity, environmental, family, sustainability, and gender implications. As the IRD will absorb the additional workload arising from the proposal with its existing resources, there are no civil service implications for the Government at this stage. Should the proposal result in further workload on the IRD which could not be coped with within existing resources in future, the IRD will review the need and seek additional resources in accordance with the established mechanism. The financial and economic implications are set out at **Annex B**.

B

PUBLIC CONSULTATION

27. The Government conducted a four-week industry consultation on our preliminary proposal from August to September 2020. The financial services industry generally welcomed the proposal and suggested a more relaxed scope of the tax concession regime, lower substantial activities requirements and a more competitive concessionary tax rate. We have taken into account the industry's feedback when preparing the proposal from paragraphs 6 to 21 above.

28. We briefed the LegCo Panel on Financial Affairs on 4 January 2021 and Members supported the proposal. Some asked about the estimated revenue forgone arising from the proposed carried interest tax concession regime and whether the benefits of the proposal to the PE industry and the economy could be quantified.

PUBLICITY

29. We will issue a press release upon the gazettal of the Bill, and arrange for a spokesman to answer media enquiries.

ENQUIRIES

30. Enquiries relating to this brief can be directed to Ms Candy Lau, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services), at 2810 2150.

**Financial Services Branch
Financial Services and the Treasury Bureau
27 January 2021**

Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Bill 2021

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Part 6B

Eligible Carried Interest and its Tax Treatment

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A BILL

To

Amend the Inland Revenue Ordinance to give profits tax and salaries tax concessions to qualifying persons and qualifying employees in relation to particular types of carried interest received by, or accrued to, the qualifying persons and the qualifying employees from the provision of investment management services by those persons and employees for certain funds and entities; to expand for the purposes of profits tax exemption the eligible classes of assets that may be held and administered by a special purpose entity on behalf of a fund that owns the entity; and to provide for related and transitional matters.

Enacted by the Legislative Council.

1. Short title

This Ordinance may be cited as the Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Ordinance 2021.

2. Inland Revenue Ordinance amended

The Inland Revenue Ordinance (Cap. 112) is amended as set out in sections 3 to 12.

3. Section 2 amended (interpretation)

Section 2(1)—

Add in alphabetical order

“*Monetary Authority* (金融管理專員) means the Monetary Authority appointed under section 5A(1) of the Exchange Fund Ordinance (Cap. 66);”

4. Section 4 amended (official secrecy)

(1) Section 4(4)(d)—

Repeal

“; or”

Substitute a semicolon.

(2) Section 4(4)(e)—

Repeal the full stop

Substitute

“; or”.

(3) After section 4(4)(e)—

Add

“(f) to the Monetary Authority, or an officer authorized by the Monetary Authority, for the purpose of seeking advice under section 12 of Schedule 16D.”.

5. Section 19CA (as amended by section 7 of the Inland Revenue (Amendment) (Profits Tax Concessions for Insurance-related Businesses) Ordinance 2020 (15 of 2020)) amended (treatment of unabsorbed losses under sections 19CAB and 19CAC: interpretation)

(1) Section 19CA, definition of *chargeable concessionary trading receipts*, paragraph (a), after “14P(1)”—

Add

“and section 4(1) of Schedule 16D”.

(2) Section 19CA, definition of *chargeable concessionary trading receipts*, paragraph (b)—

Repeal

“; and”

Substitute a semicolon.

- (3) Section 19CA, definition of *chargeable concessionary trading receipts*, paragraph (c)—

Repeal the semicolon**Substitute**

“; and”.

- (4) Section 19CA, definition of *chargeable concessionary trading receipts*, after paragraph (c)—

Add

“(d) if the assessable profits in respect of the concessionary trading receipts fall within the description in section 4(1) of Schedule 16D—the amount of the assessable profits calculated in accordance with section 6 of that Schedule;”.

- (5) Section 19CA, definition of *concession provision*, paragraph (f)—

Repeal

“or”.

- (6) Section 19CA, definition of *concession provision*, paragraph (g)—

Repeal the semicolon**Substitute**

“; or”.

- (7) Section 19CA, definition of *concession provision*, after paragraph (g)—

Add

“(h) section 4(1) of Schedule 16D;”.

- (8) Section 19CA, definition of *unabsorbed loss in respect of the concessionary trading receipts*, paragraph (a), after “14P(1)”—

Add

“and section 4(1) of Schedule 16D”.

- (9) Section 19CA, definition of *unabsorbed loss in respect of the concessionary trading receipts*, paragraph (b)—

Repeal

“; and”

Substitute a semicolon.

- (10) Section 19CA, definition of *unabsorbed loss in respect of the concessionary trading receipts*, paragraph (c)—

Repeal the semicolon**Substitute**

“; and”.

- (11) Section 19CA, definition of *unabsorbed loss in respect of the concessionary trading receipts*, after paragraph (c)—

Add

“(d) if the assessable profits in respect of the concessionary trading receipts fall within the description in section 4(1) of Schedule 16D—any loss ascertained in accordance with section 19D and section 6 of that Schedule;”.

6. Section 20AN amended (certain profits of certain funds exempt from payment of profits tax)

- (1) After section 20AN(2)—

Add

“(2A) For the purposes of subsection (2)(a), assets of a class specified in Schedule 16C may be held by a special

purpose entity on behalf of a fund that owns the entity and transactions in such assets may be carried out by the entity on behalf of the fund.”.

- (2) Section 20AN(6)—

Add in alphabetical order

“*special purpose entity* (特定目的實體) has the meaning given by section 20AO(4);”.

7. Section 20AO amended (certain profits of special purpose entities exempt from payment of profits tax)

- (1) Section 20AO(2)(b)—

Repeal

“and”.

- (2) Section 20AO(2)(c)—

Repeal the full stop

Substitute a semicolon.

- (3) After section 20AO(2)(c)—

Add

“(d) transactions in assets of a class specified in Schedule 16C; and

(e) transactions incidental (*incidental transactions*) to the carrying out of transactions mentioned in paragraph (a), (b), (c) or (d) if, in the basis period for the year of assessment, the entity’s trading receipts from the incidental transactions do not exceed 5% of the total trading receipts from—

- (i) the transactions mentioned in those paragraphs; and
(ii) the incidental transactions.”.

- (4) Section 20AO(4), definition of *special purpose entity*—

Repeal paragraph (b)

Substitute

“(b) is established solely for the purpose of holding (whether directly or indirectly) and administering only one or both of the following—

- (i) one or more investee private companies;
(ii) assets of a class specified in Schedule 16C;”.

- (5) Section 20AO(4), definition of *special purpose entity*—

Repeal paragraph (d)

Substitute

“(d) does not carry on any trade or activities except for the purpose of—

- (i) holding (whether directly or indirectly) and administering one or more investee private companies;
(ii) holding (whether directly or indirectly) and administering assets of a class specified in Schedule 16C; or
(iii) executing a legal document relating to an activity mentioned in subparagraph (i) or (ii) on behalf of the fund mentioned in paragraph (a); and”.

8. Part 6B added

After Part 6A—

Add

“Part 6B**Eligible Carried Interest and its Tax Treatment****40AC. Schedule 16D: eligible carried interest and its tax treatment**

Schedule 16D contains provisions about the tax treatment of eligible carried interest within the meaning of that Schedule.

40AD. Power to amend Schedule 16D

- (1) The Secretary for Financial Services and the Treasury may, by notice published in the Gazette, amend sections 2, 5(3), 7 and 9 of Schedule 16D.
- (2) A notice published under subsection (1) may contain any incidental, supplemental, evidential, consequential, savings and transitional provisions that are necessary and expedient in consequence of the amendments made under that subsection.”.

9. Section 51C amended (business records to be kept)

Section 51C—

Repeal subsection (5)**Substitute**

- “(5) The following provisions provide for modifications to this section—
- (a) section 10 of Schedule 16D (eligible carried interest and its tax treatment);
 - (b) section 25 of Schedule 17A (specified alternative bond scheme and its tax treatment).”.

10. Section 80 amended (penalties for failure to make returns, making incorrect returns, etc.)

- (1) After section 80(2S)—

Add

- “(2T) A person commits an offence if the person, without reasonable excuse, fails to comply with a requirement under section 10(2) of Schedule 16D.
- (2U) A person who commits an offence under subsection (2T) is liable on conviction to a fine at level 3, and the court may order the person to do, within a time specified in the order, the act that the person has failed to do.
- (2V) If a person fails to comply with an order of the court under subsection (2U), the person commits an offence and is liable on conviction to a fine at level 4.”.

- (2) Section 80—

Repeal subsection (6)**Substitute**

- “(6) The following provisions provide for modifications to this section—
- (a) section 10 of Schedule 16D (eligible carried interest and its tax treatment);
 - (b) sections 25 and 26 of Schedule 17A (specified alternative bond scheme and its tax treatment).”.

11. Schedule 16C amended (classes of assets specified for transactions for purposes of section 20AN)

- (1) Schedule 16C, heading—

Repeal

“Section 20AN”

Substitute

“Sections 20AN and 20AO”.

(2) Schedule 16C—

Repeal

“20AP & 20AS & Sch. 17A]”

Substitute

“20AO, 20AP & 20AS & Schs. 16D & 17A]”.

12. Schedule 16D added

After Schedule 16C—

Add**“Schedule 16D**

[ss. 4, 19CA, 40AC,
40AD, 51C & 80]

Eligible Carried Interest and its Tax Treatment**Part 1****Preliminary****1. Interpretation**

In this Schedule—

associated corporation (相聯法團), in relation to a corporation, means—

- (a) another corporation over which the corporation has control;

- (b) another corporation that has control over the corporation; or
- (c) another corporation that is under the control of the same person as is the corporation;

associated partnership (相聯合夥), in relation to a partnership, means—

- (a) another partnership over which the partnership has control;
- (b) another partnership that has control over the partnership; or
- (c) another partnership that is under the control of the same person as is the partnership;

certified investment fund (經核證投資基金)—see section 2 of this Schedule;

control (控制)—

- (a) in relation to a corporation, means the power of a person to secure—
- (i) by means of the holding of shares or the possession of voting power in or in relation to that corporation or any other corporation; or
- (ii) by virtue of any powers conferred by the articles of association or other document regulating that corporation or any other corporation,

that the affairs of that corporation are conducted in accordance with the wishes of the person;

- (b) in relation to a partnership, means the power of a person to secure—

- (i) by means of the holding of interests or the possession of voting power in or in relation to that partnership or any other partnership; or
- (ii) by virtue of any powers conferred by the partnership agreement or other document regulating that partnership or any other partnership,

that the affairs of that partnership are conducted in accordance with the wishes of the person;

disposal of investment (投資處置) includes part disposal of an investment and the disposal of particular investments;

eligible carried interest (具資格附帶權益)—see section 3 of this Schedule;

entity (實體) means a body of persons (corporate or unincorporate) or a legal arrangement, and includes—

- (a) a corporation;
- (b) a partnership; and
- (c) a trust;

external investor (外部投資者) means a person who participates in a certified investment fund or a specified entity as an investor without day-to-day control over the fund or entity;

investment management services (投資管理服務), in relation to a certified investment fund or a specified entity, include—

- (a) seeking funds for the fund or entity from external investors or potential external investors;
- (b) researching and advising on potential investments to be made for the fund or entity;

- (c) acquiring, managing or disposing of property or investments for the fund or entity; and
- (d) acting for the fund or entity with a view to assisting an entity in which the fund or entity has made an investment to raise funds;

profit-related return (利潤關聯回報)—see section 3 of this Schedule;

qualifying employee (合資格僱員)—see section 8(4) of this Schedule;

qualifying payer (合資格支付人)—see section 2 of this Schedule;

qualifying person (合資格人士)—see section 4(3) of this Schedule;

specified entity (指明實體)—see section 2 of this Schedule;

sum (款項) includes any money or money's worth.

2. Meaning of *certified investment fund*, *qualifying payer* and *specified entity*

In this Schedule—

certified investment fund (經核證投資基金) means a fund within the meaning of section 20AM that is certified by the Monetary Authority to be in compliance with the criteria for certification published by the Monetary Authority;

qualifying payer (合資格支付人) means—

- (a) a certified investment fund;
- (b) an associated corporation, or an associated partnership, of a certified investment fund that is a corporation or a partnership; or
- (c) a specified entity;

specified entity (指明實體) means The Innovation and Technology Venture Fund Corporation incorporated under the Companies Ordinance (Cap. 622).

3. Meaning of *eligible carried interest* and *profit-related return*

- (1) Eligible carried interest is a sum received by, or accrued to, a person by way of profit-related return from the provision of investment management services by the person for a certified investment fund or a specified entity.
- (2) A sum received by, or accrued to, a person is so received or accrued by way of profit-related return if, under the agreement governing the operation of the certified investment fund or the specified entity, all of the following conditions are satisfied—
 - (a) the sum is received or accrued after the payment of a return on investments in the fund or entity subject to the fulfilment of the hurdle rate in the fund or entity;
 - (b) the sum is to be, or may be, received or accrued only if—
 - (i) there are profits for a period on the investments, or on particular investments, made for the fund or entity; or
 - (ii) there are profits arising from a disposal of investment made for the fund or entity;
 - (c) the sum that is to be, or may be, received or accrued is variable by reference to those profits;
 - (d) the returns to external investors of the fund or entity are also determined by reference to those profits.

- (3) If a part of the sum does not satisfy any one of the conditions in subsection (2), that part is not to be regarded as received by, or accrued to, a person by way of profit-related return.
- (4) If—
 - (a) one or more sums are received by, or accrued to, a person from a certified investment fund or a specified entity by way of profit-related return in a year of assessment (*actual sums*); and
 - (b) there was no significant risk that at least a certain amount of the actual sum (*minimum amount*) would not be received by, or accrued to, the person, then the amount of the actual sum, or of the aggregate of the actual sums, that is equal to the minimum amount is not to be regarded as eligible carried interest.
- (5) For the purposes of subsection (4)(b), the risk is to be assessed—
 - (a) in relation to each actual sum (and the investments to which it relates) individually—by taking into account any other sums that might have been received by, or accrued to, the person from the certified investment fund or the specified entity instead of that actual sum; and
 - (b) in relation to the actual sum or sums, and any other sums that might have been received by, or accrued to, the person from the fund or entity by way of profit-related return in the year of assessment (and the investments to which all those sums relate)—by taking into account all those sums as a whole.
- (6) For the purposes of subsection (4)(b), the risk is also to be assessed as at the latest of—

- (a) the time when the person enters into an agreement for the provision of investment management services for the certified investment fund or the specified entity;
 - (b) the time when the person begins to carry out investment management services directly or indirectly for the fund or entity; and
 - (c) the time when a change is made to the agreement referred to in paragraph (a) so far as relating to the amount of the sums that are to be, or may be, received by or accrued to the person.
- (7) For the purposes of subsection (4)(b), any risk that a sum is prevented from being received by, or accrued to, a person (by reason of insolvency or otherwise) is to be ignored.
- (8) If more than one actual sum is received by, or accrued to, a person in a year of assessment, the minimum amount is to be apportioned between the actual sums so that, for the purposes of subsection (4)—
- (a) the part of the minimum amount that is attributable to a particular actual sum is to be apportioned to that actual sum; and
 - (b) the part of the minimum amount that is not attributable to any particular actual sum is to be apportioned between the actual sums on a just and reasonable basis.
- (9) For the purposes of subsection (8), any part of the minimum amount is attributable to a particular actual sum (so that the risk under subsection (4)(b) for that part is to be assessed in accordance with subsection (5)(a)) to the extent that there was no significant risk that that part

- would not be received by, or accrued to, the person in relation to that actual sum.
- (10) Despite subsections (2), (3), (4), (5), (6), (7), (8) and (9), any sum received by, or accrued to, a person in respect of investment management services, that—
- (a) is distributed by a specified entity; and
 - (b) arises from profits derived from a disposal of shares of an investee company (as defined by section 20AR(2)),
- is to be regarded as received or accrued by way of profit-related return.
- (11) In this section—
- hurdle rate* (門檻回報率) means a preferred rate of return on investments in a certified investment fund or a specified entity, that is stipulated in the agreement governing the operation of the fund or entity.

Part 2

Profits Tax Treatment of Eligible Carried Interest

4. Profits tax concessions for qualifying person

- (1) Where a person is chargeable to profits tax in respect of eligible carried interest for a year of assessment and all of the conditions in subsection (2) are satisfied in relation to the eligible carried interest, then—
- (a) the person's assessable profits in respect of the eligible carried interest are to be calculated in accordance with section 6 of this Schedule; and

- (b) profits tax is to be charged on those assessable profits of the person at the rate specified in section 7 of this Schedule.
- (2) The conditions are that—
- (a) for the year of assessment, the person by whom the eligible carried interest is received, or to whom the eligible carried interest is accrued, is a qualifying person;
- (b) the eligible carried interest is received by, or accrued to, the person from one, or more than one, qualifying payer;
- (c) the eligible carried interest arises from profits on investments, profits on particular investments, or profits on a disposal of investment, that are earned from a transaction—
- (i) in shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, a private company (as specified in Schedule 16C);
- (ii) in shares of, or comparable interests in, a special purpose entity or an interposed special purpose entity (as defined by section 20AO(4)) that holds (whether directly or indirectly) and administers—
- (A) one or more investee private companies (as defined by section 20AO(4)); and
- (B) no other assets of a class specified in Schedule 16C;
- (iii) in shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, an investee private company (as defined by section 20AO(4)); or

- (iv) incidental to the carrying out of a transaction mentioned in subparagraph (i), (ii) or (iii);
- (d) if the profits that are earned from a transaction mentioned in paragraph (c) are from a transaction by a certified investment fund or a special purpose entity—those profits are exempt from profits tax in accordance with section 20AN or 20AO.
- (3) A person is a qualifying person for a year of assessment if, during the basis period for the year of assessment, the person—
- (a) is a corporation licensed under Part V of the Securities and Futures Ordinance (Cap. 571) to carry on, or an authorized financial institution registered under that Part for carrying on, a business in any regulated activity as defined by Part 1 of Schedule 5 to that Ordinance;
- (b) carries out investment management services in Hong Kong, or arranges such services to be carried out in Hong Kong, for a certified investment fund that is a qualified investment fund as defined by section 20AN(6); or
- (c) carries out investment management services in Hong Kong, or arranges such services to be carried out in Hong Kong, for a specified entity.
- 5. Investment management services carried out in Hong Kong**
- (1) Section 4(1) of this Schedule does not apply to a person in relation to eligible carried interest received by, or accrued to, the person from the provision of investment management services by the person for a certified investment fund or a specified entity for a year of

- assessment unless the person satisfies the conditions in both subsections (2) and (3).
- (2) The condition in this subsection is satisfied if, during the whole of the applicable period, the investment management services concerned are—
- (a) either—
- (i) carried out in Hong Kong by the person; or
- (ii) arranged by the person to be carried out in Hong Kong; and
- (b) not carried out outside Hong Kong by a permanent establishment (that is, a branch, management or other place of business, but not including an agency, unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of a principal).
- (3) The condition in this subsection is satisfied if, during the whole of the applicable period—
- (a) the average number of full-time employees in Hong Kong who carry out the investment management services concerned and have the qualifications necessary for doing so during the basis period for each year of assessment falling within the applicable period is—
- (i) adequate in the opinion of the Commissioner; and
- (ii) in any event, 2 or more; and
- (b) the total amount of operating expenditure incurred in Hong Kong for the provision of the investment management services concerned during the basis period for each year of assessment falling within the applicable period is—

- (i) adequate in the opinion of the Commissioner; and
- (ii) in any event, \$2,000,000 or more.

(4) In this section—

applicable period (適用期間) means the period beginning on the day on which a person begins to carry out investment management services directly or indirectly for a certified investment fund or a specified entity and ending on the day on which eligible carried interest is received by, or accrued to, the person.

6. Profits tax calculation for qualifying person

- (1) If section 4(1) of this Schedule applies to a qualifying person in relation to eligible carried interest—
- (a) the person is chargeable to profits tax for the basis period for a year of assessment on the net eligible carried interest calculated in accordance with subsection (2); and
- (b) the person's assessable profits in respect of the eligible carried interest are to be calculated on the basis of the net eligible carried interest calculated in accordance with subsection (2).
- (2) The calculation of net eligible carried interest is in accordance with the following formula—

$$A = B - C - D + E$$

where: A means the net eligible carried interest;

B means the eligible carried interest received by, or accrued to, the qualifying person from one, or more

- than one, qualifying payer during the basis period for the year of assessment;
- C means the outgoings and expenses to the extent that they are incurred during the basis period for the year of assessment to produce B;
- D means the allowances allowed under Part 6, to the extent that the relevant assets counted for the allowances are used during the basis period for the year of assessment to produce B;
- E means the balancing charge to be made under Part 6, to the extent that the relevant assets counted for the balancing charge are used during the basis period for the year of assessment to produce B.

7. Rate of profits tax for qualifying person

For a year of assessment commencing on or after 1 April 2020, the rate of profits tax in respect of the net eligible carried interest mentioned in section 6 of this Schedule is 0%.

Part 3

Salaries Tax Treatment of Eligible Carried Interest

8. Salaries tax concessions for qualifying employee

- (1) This section applies to an individual who, for a year of assessment, is a qualifying employee.

- (2) If assessable income is accrued to a qualifying employee from an employment under which investment management services are provided by the employee for, or on behalf of, a qualifying person for a certified investment fund or a specified entity, the employee's assessable income from the employment for the year of assessment is to be calculated in accordance with subsection (3).
- (3) The calculation is in accordance with the following formula—

$$A = B - (C \times D)$$

- where:
- A means the assessable income accrued from the employment for the year of assessment;
- B means the income accrued from the employment for the year of assessment;
- C means that part of B paid out of the eligible carried interest received by, or accrued to, a qualifying person and to which section 4(1) of this Schedule applies for the assessment of that eligible carried interest for profits tax;
- D means the percentage specified in section 9 of this Schedule.

- (4) In this section—
- qualifying employee* (合資格僱員) means an individual who satisfies both of the following conditions—
- (a) the individual is employed by—
- (i) a qualifying person; or

- (ii) the associated corporation, or the associated partnership, of a qualifying person who is a corporation or a partnership, if the associated corporation or the associated partnership carries on a business in Hong Kong;
- (b) the individual is carrying out the duties of the employment by providing investment management services in Hong Kong for, or on behalf of, the qualifying person.

9. Percentage of eligible carried interest to be excluded for salaries tax calculation

For a year of assessment commencing on or after 1 April 2020, the percentage mentioned in section 8(3) of this Schedule is 100%.

Part 4

Provision of Information and Retention of Records

10. Obligations of qualifying person: information and records

- (1) Part 9 and section 80 apply, with the modifications specified in this section, to a person who makes a claim to the Commissioner that—
 - (a) the person is a qualifying person; and
 - (b) eligible carried interest received by, or accrued to, the person is to be assessed for profits tax in accordance with section 4(1) of this Schedule for a year of assessment.

- (2) The person must provide to the Commissioner in the person's return or in other manner or form that may be required by the Commissioner—
 - (a) the information in relation to the eligible carried interest; and
 - (b) the additional information in relation to an employee of the person, if—
 - (i) the person makes a payment or an accrual of eligible carried interest to the employee; and
 - (ii) the employee makes a claim to the Commissioner that—
 - (A) the employee is a qualifying employee; and
 - (B) eligible carried interest received by, or accrued to, the employee is to be assessed for salaries tax in accordance with section 8 of this Schedule for a year of assessment.
- (3) The additional information in relation to an employee includes—
 - (a) the employee's name;
 - (b) the employee's address;
 - (c) the employee's Hong Kong Identity Card number (or the number and issuing country of the employee's passport);
 - (d) the amount of eligible carried interest received by, or accrued to, the employee for the year of assessment; and

- (e) details of the qualifying payer from which the eligible carried interest was received by, or accrued to, the employee for the year of assessment.
- (4) For the purposes of section 51C, a person mentioned in subsection (1) must—
 - (a) keep sufficient records to enable the accuracy and completeness of a payment or an accrual of eligible carried interest made by the person to be readily ascertained; and
 - (b) retain the records for a period of not less than 7 years beginning on the date of the payment or the accrual of eligible carried interest, whichever is the later.
- (5) Section 80 applies to a failure to comply with section 51C, as modified by subsection (4), in the same way that section 80 applies to a failure to comply with that section 51C.

11. Obligations of qualifying payer: information and records

- (1) This section applies to a qualifying payer if—
 - (a) a person makes a claim to the Commissioner that—
 - (i) the person is a qualifying person; and
 - (ii) eligible carried interest received by, or accrued to, the person is to be assessed for profits tax in accordance with section 4(1) of this Schedule for a year of assessment; and
 - (b) the eligible carried interest was paid or accrued to the person by the qualifying payer for the year of assessment.
- (2) The qualifying payer must provide to the Commissioner the information that may be required by the Commissioner in relation to the payments or the accruals

- of eligible carried interest made to the person mentioned in subsection (1).
- (3) For the purposes of providing information to the Commissioner, the qualifying payer must—
 - (a) keep sufficient records to enable the accuracy and completeness of a payment or an accrual of eligible carried interest made by the qualifying payer to be readily ascertained; and
 - (b) retain the records for a period of not less than 7 years beginning on the date of the payment or the accrual of eligible carried interest, whichever is the later.
- (4) If a qualifying payer fails to comply with the requirements in subsection (2) or (3), the Commissioner may determine that—
 - (a) the person making the claim is not a person by whom the eligible carried interest is received, or to whom the eligible carried interest is accrued; and
 - (b) the eligible carried interest is not to be assessed for profits tax in accordance with section 4(1) of this Schedule.

Part 5

Miscellaneous Matters

- 12. Commissioner may seek advice from Monetary Authority on certain matters
 - (1) This section applies if a claim is made by a person to the Commissioner in relation to—
 - (a) profits tax treatment of eligible carried interest under section 4 of this Schedule; or

(b) salaries tax treatment of eligible carried interest under section 8 of this Schedule.

(2) After receiving the claim, the Commissioner may seek advice from the Monetary Authority, or an officer authorized by the Monetary Authority, in order to ascertain—

(a) whether a service constitutes an investment management service;

(b) whether a sum has been received by, or accrued to, a person by way of profit-related return so that it may be eligible carried interest;

(c) whether an entity is, and has remained, a certified investment fund; and

(d) any other matter that the Commissioner considers appropriate in relation to the claim.

13. Anti-avoidance provisions relating to arrangement to obtain tax benefit

(1) If—

(a) a person enters into an arrangement; and

(b) the Commissioner is satisfied that the main purpose, or one of the main purposes, of the person entering into the arrangement is to obtain a tax benefit, whether for the person or any other person, in relation to a liability to pay profits tax or salaries tax in respect of eligible carried interest under this Schedule,

this Schedule does not apply in relation to any sums received by, or accrued to, the person or any other person during a basis period for a year of assessment relevant to the arrangement.

(2) For the purposes of subsection (1), a basis period for a year of assessment is relevant to an arrangement if, in the opinion of the Commissioner, the arrangement has effect during the basis period.

(3) Without limiting subsection (1), an arrangement to disguise as eligible carried interest a management fee that a person receives, or that accrues, from a qualifying payer is an arrangement to obtain a tax benefit.

(4) In this section—

management fee (管理費用), in relation to a certified investment fund or a specified entity, means a sum received by, or accrued to, a person from the provision of investment management services by the person for the fund or entity, except in so far as the sum constitutes eligible carried interest;

tax benefit (稅務利益) means an avoidance, postponement or reduction of a liability to pay tax.

14. Loss sustained by qualifying person

(1) This section applies to a qualifying person if, because of sections 4, 6 and 7 of this Schedule, the person does not need to pay any profits tax in respect of eligible carried interest for a year of assessment.

(2) Any associated loss is not available for set off against any of the assessable profits of the person for the year of assessment or any subsequent year of assessment.

(3) In this section—

associated loss (相聯虧損) means any loss sustained by a qualifying person in a year of assessment in respect of eligible carried interest received by, or accrued to, the

person arising from a transaction mentioned in section 4(2)(c) of this Schedule.

Part 6

Application

15. Application of this Schedule

- (1) The tax treatment of eligible carried interest under this Schedule applies in relation to eligible carried interest received by, or accrued to, a qualifying person or a qualifying employee on or after 1 April 2020, for any year of assessment commencing on or after that date.
- (2) To avoid doubt, this Schedule does not apply in relation to eligible carried interest received by, or accrued to, a qualifying person before 1 April 2020 but falling within the basis period for a year of assessment commencing on or after 1 April 2020.
- (3) For any year of assessment mentioned in subsection (1), this Schedule applies in relation to eligible carried interest received by, or accrued to, a qualifying person or a qualifying employee in the period beginning on 1 April 2020 and ending on the day immediately before the date of commencement of the Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Ordinance 2021 (of 2021) as it applies in relation to eligible carried interest received or accrued after that period.”.

Explanatory Memorandum

The main object of this Bill is to amend the Inland Revenue Ordinance (Cap. 112) (*Ordinance*) to give profits tax and salaries tax concessions to qualifying persons and qualifying employees in relation to carried interest received by, or accrued to, the qualifying persons and the qualifying employees from the provision of investment management services by those persons and employees for certain funds and entities, commonly known as private equity funds.

2. Clause 1 sets out the short title.
3. Clause 8 adds a new Part 6B to the Ordinance to introduce the tax concession regime for eligible carried interest, which is set out in a new Schedule 16D added to the Ordinance by clause 12. The new Part 6B also empowers the Secretary for Financial Services and the Treasury to, by notice published in the Gazette, amend sections 2, 5(3), 7 and 9 of the new Schedule 16D and make incidental, supplemental, evidential, consequential, savings and transitional changes that are necessary and expedient in consequence of the amendments.
4. The new Schedule 16D contains 6 Parts.
5. Part 1 of the new Schedule 16D provides for the definitions of *associated corporation*, *associated partnership*, *certified investment fund*, *control*, *disposal of investment*, *eligible carried interest*, *entity*, *external investor*, *investment management services*, *profit-related return*, *qualifying employee*, *qualifying payer*, *qualifying person*, *specified entity* and *sum*.
6. Part 2 of the new Schedule 16D contains provisions on profits tax treatment of eligible carried interest for a qualifying person (within the meaning of section 4(3) of that Schedule), including provisions setting out the conditions to be satisfied, the transactions that give rise to eligible carried interest and the calculation and the rate of

- profits tax in respect of eligible carried interest. In that Part, the rate of profits tax is set at 0%.
7. Part 3 of the new Schedule 16D contains provisions on salaries tax treatment of eligible carried interest for a qualifying employee (as defined by section 8(4) of that Schedule), including provisions setting out the conditions to be satisfied by the employee, the calculation of the employee's salaries tax assessable income and the percentage of eligible carried interest to be excluded for the calculation. In that Part, the percentage is set at 100%.
 8. Part 4 of the new Schedule 16D contains provisions on the obligations of a qualifying person (section 10 of that Schedule) and qualifying payer (section 11 of that Schedule) in relation to provision of information and retention of records.
 9. Part 5 of the new Schedule 16D contains provisions to enable the Commissioner of Inland Revenue to seek advice from the Monetary Authority on certain matters in the event of a claim, provisions to prevent tax avoidance relating to arrangement to obtain tax benefit, and provisions to prevent set off of certain losses sustained by qualifying persons against their assessable profits.
 10. Part 6 of the new Schedule 16D provides that the tax treatment of eligible carried interest under that Schedule applies in relation to eligible carried interest received by, or accrued to, a qualifying person or a qualifying employee on or after 1 April 2020, for any year of assessment commencing on or after that date.
 11. The Bill also contains the following related amendments—
 - (a) clause 3 adds the definition of *Monetary Authority* to section 2(1) of the Ordinance and clause 4 amends section 4 of the Ordinance to include references to the Monetary Authority, so as to facilitate the seeking of advice from the Monetary Authority provided under section 12 of the new Schedule 16D;

- (b) clause 5 amends section 19CA of the Ordinance (as amended by section 7 of the Inland Revenue (Amendment) (Profits Tax Concessions for Insurance-related Businesses) Ordinance 2020 (15 of 2020)) to amend the definitions of *chargeable concessionary trading receipts*, *concession provision* and *unabsorbed loss in respect of the concessionary trading receipts*, so that those definitions may apply in relation to the new Schedule 16D;
 - (c) clauses 9 and 10 amend sections 51C and 80 of the Ordinance respectively to apply the record-keeping and provision of information requirements and the penalties under those sections to a qualifying person set out in section 10 of the new Schedule 16D.
12. Clauses 6 and 7 amend sections 20AN and 20AO of the Ordinance respectively to expand for the purposes of profits tax exemption the eligible classes of assets that may be held and administered by a special purpose entity on behalf of a fund that owns the entity. In particular, clause 7 amends the definition of *special purpose entity* in section 20AO(4) of the Ordinance to make it clear that the entity can hold and administer assets of a class specified in Schedule 16C to the Ordinance. Clause 11 consequentially amends Schedule 16C to the Ordinance to include references to section 20AO of the Ordinance and the new Schedule 16D.

Financial and Economic Implications of the Proposal

Financial Implications

The proposed tax concession regime for carried interest seeks to attract more PE funds to operate in Hong Kong, thereby generating more demands for investment management services, relevant professional services and related activities. It is difficult to estimate the revenue forgone arising from the carried interest tax concession regime as many PE funds are currently carrying out their business and investment management activities offshore. On the other hand, if more PE funds will be attracted to operate in Hong Kong, other service income (including management fees) or employment income received by qualifying carried interest recipients for providing investment management services in Hong Kong and service fees received by other professionals for providing professional services (e.g. legal, banking and accounting services) to the PE funds and investment managers in the course of a trade, profession or business carried on in Hong Kong will be chargeable to tax in Hong Kong. After the implementation of the proposed tax concessions, the Government will assess its effectiveness on an ongoing basis to ensure that the overall objective of consolidating Hong Kong's position as Asia's premier fund hub for PE and thereby benefiting the economy as a whole is achieved.

Economic Implications

2. The proposal would attract more PE funds to operate in Hong Kong, thereby generating more demand for investment management and other related professional services, including financial, legal, and accounting services. The proposal would help foster Hong Kong's position as Asia's premier fund hub for PE and the further development of our financial services industry as a whole, and consolidate Hong Kong's status as an international financial centre.