

**Second Consultation Paper on Exemption of Offshore Funds from Profits Tax
Comparison between PricewaterhouseCoopers' Response Paper and the
Administration's Proposal**

	PwC Response Paper submitted on 31 January 2005	Administration's Proposal to be discussed on 4 April 2005
A. Major Concerns with the Exemption Provisions		
1. Section 20AA broker / advisor requirement	To eliminate the tests of "associate" and "independent capacity" for brokers and investment advisers.	Paragraph 9 (iii) - Proposed to dispense with these two existing criteria.
2. Securities trading transactions	To include all investment profits derived from Hong Kong by the offshore funds.	Not addressed.
3. Carrying on "other business" in Hong Kong	To define the meaning of carrying on "other business" in Hong Kong. Clarification of the undefined term "non- resident".	Paragraph 9 (iv) – income derived by non-residents, which is incidental to the exempted business will not taint the tax exemption. But such incidental income should not exceed 5% of the total income. Not addressed.
B. Major Concerns with the Deeming Provisions		
1. Catching genuine offshore investors	To clarify the meaning of the term "resident". A concern that genuine offshore investors trading Hong Kong securities being unfairly exposed to profits tax.	Not addressed. Not addressed. Proposing that the Deeming Provisions will only apply to funds which are not bona fide widely held.
2. The threshold	Suggesting economic control (i.e. 51% or more of the beneficial economic interest) rather than legal control to be the vital test.	Paragraph 11(b) – inviting comments on whether the threshold should be 30% or 50%.

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3. Calculation of the threshold	Uncertainties and practical difficulties - average holding throughout a period of time or the year-end holding?	Not addressed.
4. Obtaining information from the Fund	Investors with 30% holding may not have power to request information of the Fund.	Paragraph 11(b) – believing information should be available to such significant investors.
5. Treatment of losses	Can losses be offset against assessable profits?	Not addressed.
6. Double taxation	On the same income in Hong Kong.	Not addressed.
	On the same income in Hong Kong and other jurisdiction.	Not addressed.
7. The concept of “see-through”	New concept of “see-through” would create a potential deviation from existing Hong Kong principles which exempt capital gains.	Not addressed.
C. Other Issues		
1. Effective Date	The Exemption Provisions – retrospectively applied	Paragraph 12 – The Exemption Provisions to apply retrospectively to the year of assessment commencing on 1 April 1996.
	The Deeming Provisions – prospectively applied	The Deeming Provisions to take effect upon enactment of the Bill.
2. Start-up Funds	Funds with start-up capital of no more than HK\$5 million to be exempt for the first 3 accounting periods	Not addressed.

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	from the date of the fund's establishment.	
3. Listed but not authorized funds	To clarify the tax exempt status of the Funds listed on the Hong Kong Stock Exchange that are not SFC authorized.	Not addressed.
The draft bill	To go through another round of consultation before submitting it to the Legislative Council.	To submit in the current legislative year and inviting the panel members' comments on the Administration's proposal on 4 April 2005.

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