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BRIEFING

PROFITS TAX EXEMPTION FOR OFFSHORE PRIVATE EQUITY FUNDS – IMPLICATIONS ON SFC LICENSING REQUIREMENTS

LEGISLATIVE BACKGROUND

The Hong Kong Government gazetted the Inland Revenue (Amendment) (No.2) Ordinance 2015 (the “**Ordinance**”) on 17 July 2015, extending the profits tax exemption to private equity funds which previously may not have been available to them. The Ordinance will take retrospective effect, applying in respect of tax chargeable for any year of assessment commencing on or after 1 April 2015.

Below are the three key changes:

1. The definition of “securities” (relevant to determining whether a transaction is a “specified transaction”) has been broadened to include shares of excepted private companies.

“excepted private company” is broadly a private company incorporated overseas, which does not within three years prior to the relevant transaction (a) carry on business through or from a permanent establishment in Hong Kong; (b) hold Hong Kong immovable property, or a direct or indirect interest in a private company with a direct or indirect holding of Hong Kong immovable property above a threshold of 10% of the company’s own assets and (c) hold a direct or indirect interest in a private company carrying on business through a Hong Kong permanent establishment above a threshold of 10% of the company’s own assets.

The change effectively means that, whereas prior to the legislative amendments the profits tax exemption for offshore funds have been largely confined to funds which are hedge fund type funds, with the amendments such exemptions are extended to private equity type funds.

2. Prior to the legislative amendments, the profit tax exemption for offshore funds required transactions to be carried out through or arranged by an SFC-licensed or registered authorized financial institutions or corporation. With the legislative amendments, exemptions would also apply to offshore funds which are “Qualifying Funds”.

A “qualifying” fund means a fund complying with the following conditions:

- (a) at all times after the final closing of sale of interests-
 - (i) the number of investors exceeds 4; and
 - (ii) the capital commitments made by investors exceed 90% of the aggregate capital commitments; and
 - (b) the portion of net proceeds arising from the fund’s transactions to be received by the originator (and its associates) must not exceed 30% of the net profit.
3. Hong Kong and offshore incorporated special purpose vehicles (SPV) may be exempted from profit tax derived from transactions in securities in an interposed SPV or an excepted private company.

IMPLICATIONS FOR SFC LICENSING REQUIREMENTS

If your existing business was one that involved the management of an offshore fund which invests primarily in offshore private companies (ie private equity type funds), then you may have up to now structured the management of such fund in such a way that one or more regulated activities (eg the management of such fund) have been conducted outside of Hong Kong (eg in order not to trigger the requirements for a SFC Type 9 (asset management) license). The reason for doing so hitherto may have been (i) because you do not want your activities in Hong Kong to trigger Hong Kong SFC licensing requirements; and/or (ii) because you do not want your activities in Hong Kong to be conducted in such a way that your offshore fund may be subject to profits tax in Hong Kong.

With the legislative changes, the reason stated in (ii) above largely becomes redundant and hence if that has been a main driver in the way you operate your fund management business, it may be worthwhile to re-examine your *modus operandi* to see if you may wish to move more activities onshore to Hong Kong. There may be some practical benefits in doing so but it may also trigger SFC licensing requirements or may have other SFC licensing implications.

For further details on how we can assist you, please contact us at (852) 3611 0313 or ben.wong@ycylawyers.com.hk.

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