

**Legislative Proposal to Extend  
Profits Tax Exemption for Offshore Funds to  
Private Equity Funds**

Legislative Council  
Panel on Financial Affairs  
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**Asset management industry  
in Hong Kong**

- Combined fund management business (as at end 2013): HK\$16,007 billion
- Year-on-year growth of 27% from 2012
- Hong Kong is among the top asset management hubs in Asia

## Private equity industry in Hong Kong

### End 2013

- Total capital under management in private equity funds: US\$99 billion
- Year-on-year growth of 16% from 2012

### End September 2014

- Total capital under management in private equity funds : US\$111 billion
- 21% of Asia's total capital under management in private equity

3

## Our Proposal

- Policy Objectives:
  - ▣ To strengthen Hong Kong's status as a premier international asset management centre
  - ▣ To develop Hong Kong into a full-service, all-round asset management hub
- It is proposed in the 2013-14 Budget to extend the profits tax exemption for offshore funds to include transactions in private companies which are incorporated outside Hong Kong.
- To attract more private equity fund managers to hire local asset management, investment and advisory services, and drive demand for other relevant professional services.

4

## Current tax exemption applicable to offshore funds

Current exemption provisions:

- Non-resident entities are exempt from profits tax for profits derived from:
  - “specified transactions” (covering those transactions an offshore fund would typically perform in Hong Kong, including transactions in **securities**); and
  - “transactions incidental to the carrying out of the specified transactions”.
- “Specified transactions” must be carried out by “specified persons” (corporations and authorized financial institutions licensed or registered under the Securities and Futures Ordinance) or arranged by a “specified person”.

5

## Current tax exemption applicable to offshore funds

- The current definition of “securities” does not include securities of a private company.
- Offshore private equity funds that make use of the services of Hong Kong investment manager to derive profits from transactions in securities of private companies could be subject to Hong Kong profits tax.

6

## Legislative Proposal

### *(a) Extending tax exemption to offshore private equity funds*

- To amend the definition of “securities” such that a transaction in securities in an eligible private company (i.e. portfolio company) will not be excluded from a “specified transaction”.

7

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- To qualify for tax exemption, a portfolio company should meet the following conditions, including –
  - (a) it is a private company incorporated outside Hong Kong;
  - (b) within the 3 years before a transaction in securities in the portfolio company, it did not (i) carry on any business through or from any permanent establishment in Hong Kong; and (ii) hold immovable property in Hong Kong.
- Subject to a de minimis rule

8

## Legislative Proposal

*(b) Allowing offshore qualified private equity funds to enjoy tax exemption*

- Offshore private equity funds are not necessarily managed by SFC licensees.
- To add a provision: If the offshore private equity fund conducting the specified transaction is a “qualifying fund”, it could be eligible for tax exemption.

9

## Legislative Proposal

- To be a “qualifying fund”, the following conditions must be met:
  - (a) at all times after the final close of sale of interests –
    - (i) there are five or more investors (who are not associates of the originator of the fund);
    - (ii) the capital commitments made by investors exceed 90% of the aggregate capital commitments; and
  - (b) the portion of net proceeds to be received by the originator and the originator’s associates does not exceed 30% of the net proceeds arising from the transactions of the fund.

10

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- To prevent abuse, the existing deeming provisions will equally apply to offshore private equity funds, which means:

A resident person holding a beneficial interest of 30% or more in a tax-exempt “qualifying fund” will be deemed to have derived assessable profits in respect of profits earned by the offshore private equity fund.

11

## Legislative Proposal

### *(c) Allowing tax exemption for Special Purpose Vehicles (SPVs)*

- To amend the definition of “securities” such that a transaction in securities in an SPV will not be excluded from the definition of “specified transaction”.
- To add an express provision to give tax exemption to an SPV in respect of profits derived from (i) a transaction in securities in an interposed SPV or (ii) an eligible offshore portfolio company.

12

## Legislative Proposal

- Special Purpose Vehicles
  - could be a corporation, partnership, trustee of a trust estate or a non-corporate body incorporated, registered or appointed in or outside Hong Kong.
  - Could be wholly or partially owned by a non-resident person
  - should be established solely for the purpose of holding, directly or indirectly, or administering the qualified portfolio company.

13

## Way Forward

- Finalizing the amendments to the Inland Revenue Ordinance
- Aiming to introduce the Bill into the Legislative Council in the first half of 2015

14

THE END