

**For discussion
on 1 February 2021**

Legislative Council Panel on Financial Affairs

Re-domiciliation mechanism for foreign funds

PURPOSE

This paper briefs Members on the legislative proposals to allow foreign investment funds to re-domicile to Hong Kong as Open-ended Fund Companies or Limited Partnership Funds.

BACKGROUND

2. We have witnessed in recent years robust growth in wealth creation in Asia, increase in portfolio allocation to the Asian markets, and deepening financial market liberalisation in Mainland China. All these are beneficial to Hong Kong's development as a premier asset and wealth management centre in the region. The Government has been stepping up efforts to sharpen Hong Kong's competitive edge on this front. One of our key policy tools is to encourage fund formation and operation in Hong Kong through diversifying and enhancing our fund structures with a view to developing Hong Kong into a preferred fund domicile.

3. As a result of the efforts of the Government and financial regulators in establishing the Open-ended Fund Company ("OFC")¹ and

¹ OFC is a corporate form of public/private investment funds under the regulation of the Securities and Futures Commission ("SFC"). An OFC has the flexibility to issue and cancel shares for investors' subscription and redemption in the funds. As at 21 Jan 2021, eight OFCs have been set up.

Limited Partnership Fund (“LPF”)² regimes, through the amendment of the Securities and Futures Ordinance (Cap. 571) and the enactment of the Limited Partnership Fund Ordinance (Cap. 637) in July 2018 and August 2020 respectively, an investment fund may now be established in Hong Kong in the form of a company or a limited partnership, in addition to the long established form of a unit trust. Currently, most funds active in Hong Kong are offshore funds (i.e. with their central management and control exercised outside Hong Kong). Nevertheless, the existing OFC and LPF regimes have yet to provide for a re-domiciliation mechanism to attract more funds to be based in Hong Kong.

4. In view of the latest regulatory developments in traditional offshore fund jurisdictions³ which are rendering it increasingly costly to set up and maintain offshore funds, the industry anticipate that more investment funds would consider moving “onshore” to where their substantial activities are conducted. Hong Kong would be a logical choice for many fund managers given our strong community of investors and professional service providers, proximity to Mainland China and active initial public offering market for conducting fundraising, deal sourcing and investment management activities.

5. A task force led by the Financial Services and the Treasury Bureau, comprising members from the Hong Kong Monetary Authority, the SFC and the Inland Revenue Department, has come up with the legislative proposals on re-domiciliation of OFCs and LPFs as set out in

² LPF regime is a registration regime for investment funds under the Companies Registry’s administration. Limited partnership is a common constitution form for private funds such as private equity funds. In a limited partnership, the general partner (i.e. operating person) with unlimited liability in respect of the debts and obligations of the fund and the limited partner(s), who are essentially investors, with limited liability will have freedom of contract in respect of the operation of the partnership. Most LPFs are privately-offered investment funds targeted at professional investors unless SFC’s authorisation for public offering is obtained. As at 21 Jan 2021, 81 LPFs have been set up.

³ For example, traditional offshore fund jurisdictions have introduced economic substance requirements to meet the obligations under the Organisation for Economic Co-operation and Development (“OECD”)’s Base Erosion and Profit Shifting initiative since 2019. Specifically, business entities which are registered in these jurisdictions and carrying out geographically mobile activities will need to perform their core income generating activities in these jurisdictions by employing an adequate number of qualified employees and incurring an adequate amount of operating expenditure in these jurisdictions. If the entities do not comply with the requirements, these jurisdictions will be required to spontaneously exchange relevant information about the entities with the jurisdictions of residence of the immediate parent, ultimate parent, and ultimate beneficial owner of the entities.

paragraphs 6 to 14 below. In doing so, the task force has taken into account the local market landscape, overseas regulatory experience, as well as international market and regulatory trends. The objective is to create a commercially viable and facilitating mechanism with legal and tax certainty for foreign funds set up in corporate or limited partnership form to re-locate to Hong Kong, with a view to enhancing the attractiveness of the OFC and LPF regimes and the competitiveness of Hong Kong as an international asset and wealth management hub. It will also bring more jobs and business opportunities to the local fund and professional services industries.

KEY FEATURES OF THE PROPOSALS

6. Under the proposed mechanism, a fund set up in corporate or limited partnership form under the laws of a jurisdiction outside Hong Kong is eligible to be registered as an OFC or LPF in Hong Kong respectively, if it meets the same set of eligibility requirements for a new fund to be registered as an OFC⁴ or an LPF⁵ respectively. Upon re-domiciliation, the fund would have the same rights and obligations as any other newly established OFCs or LPFs in Hong Kong.

7. The proposed mechanism provides for the preservation of the continuity of the fund upon re-domiciliation, and is not intended to:

- (a) create a new legal entity;
- (b) prejudice or affect the identity or continuity of the fund as previously incorporated or registered before its registration in Hong Kong;

⁴ As set out in section 112E of the Securities and Futures Ordinance (Cap. 571), including requirements relating to the directors, investment manager and custodian of an OFC.

⁵ As set out in section 7 of the Limited Partnership Fund Ordinance (Cap. 637). For example, the fund has one general partner and at least one limited partner, the fund is constituted by a limited partnership agreement, the fund has an office in Hong Kong to which communications and notices may be sent, etc..

- (c) affect any contract made, resolution passed or any other act or thing done in relation to the fund before its registration in Hong Kong;
- (d) affect the rights, functions, liabilities or obligations, and property of the fund before its registration in Hong Kong; or
- (e) render defective any previous legal proceedings by or against the fund.

Re-domiciliation mechanism for OFC

8. For registration of a non-Hong Kong corporate fund as an OFC in Hong Kong, an application should be made to the SFC with the applicable fee. With reference to the existing requirements of setting up a new OFC and overseas experience, we propose the application to be accompanied, *inter alia*, by the following information / documents:

- (a) the original name of the non-Hong Kong fund and the place of incorporation or registration;
- (b) a copy of certificate of incorporation or registration issued with respect to the fund (and other documents that evidence the establishment of each of the sub-funds, if any, of the fund) under the law of the place of incorporation or registration;
- (c) the constitutive document of the fund;
- (d) a certificate issued by the fund's directors to confirm:
 - (i) that the proposed re-domiciliation is not prohibited by and approved in accordance with the fund's constitutive document or any contract or undertaking given by the fund;
 - (ii) that the de-registration of the fund is not prohibited under the laws of the place of incorporation or registration;
 - (iii) the solvency of the fund and each of its sub-funds;

- (iv) the absence of any petition of winding-up, liquidation, receivership or arrangement or compromise arrangement in respect of the fund or any of its sub-funds; and
- (v) service of notice of the proposed re-domiciliation to its creditors.

9. If satisfied with the application, the SFC would register the non-Hong Kong corporate fund, and notify the Registrar of Companies (“RoC”) who would issue a certificate of re-domiciliation in respect of the fund whereupon the registration by the SFC would come into effect. The re-domiciled OFCs will be included in the register of OFCs maintained by the RoC and available on the SFC’s website for public inspection.

10. After the issue of the certificate of re-domiciliation, the fund concerned would be required to notify the SFC and provide evidence of de-registration in its place of incorporation within 60 days, failing which its registration with the SFC would be cancelled.

Re-domiciliation mechanism for LPF

11. To register a non-Hong Kong fund set up in limited partnership form as an LPF in Hong Kong, an application should be made to the RoC with the applicable fees. The information required in the application is similar to what is required for a new fund’s application under the LPF regime⁶. The application should be submitted by a registered Hong Kong law firm or a solicitor admitted to practice Hong Kong law in Hong Kong on behalf of the fund. Modelling on the re-domiciliation mechanisms in other jurisdictions, we propose to also require the application to, *inter alia*:

- (a) state the original name of the non-Hong Kong fund and the place of establishment;

⁶ As set out in Schedule 1 to the Limited Partnership Fund Ordinance (Cap. 637). The required information includes the proposed name of the fund, investment scope and principal place of business, details of the general partner, investment manager, responsible person (for carrying out anti-money laundering and counter-terrorist financing measures), etc..

- (b) include a statement and declaration confirming that:
 - (i) any consent or approval for the proposed registration as LPF and the de-registration of the fund in its place of establishment required by any contract or undertaking given by the fund has been obtained or waived;
 - (ii) the de-registration of the fund in its place of establishment is not prohibited under the laws of the place of establishment; and
 - (iii) the fund will be de-registered in its place of establishment within 60 days after re-domiciliation.

12. If satisfied that the application for registration meets the specified requirements, the RoC will register the fund as an LPF and issue a certificate of registration as proof of registration. The re-domiciled LPFs will be included in the register of LPFs maintained by the RoC and made available for public inspection.

13. After the issue of the certificate of registration, the fund concerned would be required to be de-registered in its place of establishment within 60 days, failing which the RoC may strike the name of the fund off the LPF Register.

The roles of the relevant authorities

14. Similar to the roles of the SFC or the RoC in respect of new funds applying for registration as OFCs or LPFs respectively, in the case of re-domiciliation, it is the duty of an applicant to ensure that the documents/information submitted are factually correct and in order. The roles of the SFC and the RoC in respect of re-domiciliation registration would also be similar to those of the SFC and the RoC in respect of registration of new OFCs and LPFs currently.

Legislative amendment proposals

15. For the purpose of providing a statutory re-domiciliation mechanism for OFCs, key amendments are proposed to be made to the Securities and Futures Ordinance (Cap. 571), Securities and Futures

(Open-ended Fund Companies) Rules (Cap. 571AQ) and Securities and Futures (Open-ended Fund Companies) (Fees) Regulation (Cap. 571AR). In the case of LPFs, it is proposed to make key amendments to the Limited Partnership Fund Ordinance (Cap. 637).

PROFITS TAX AND STAMP DUTY TREATMENT

16. We intend to apply the same profits tax⁷ and stamp duty⁸ arrangements to re-domiciled funds as newly formed OFCs or LPFs. The re-domiciliation as an OFC or an LPF does not amount to a transfer of assets of the fund or a change in the beneficial ownership of the assets of the fund. This entails that the re-domiciliation process would not give rise to any stamp duty implications. Such an arrangement aligns with the tax treatment of the existing mechanism for funds registered under the Limited Partnerships Ordinance (Cap. 37) to migrate to the Limited Partnership Fund Ordinance (Cap. 637).

⁷ Like other funds operating in Hong Kong, a privately-offered OFC or an LPF meeting the definition of “fund” under section 20AM of the Inland Revenue Ordinance (Cap. 112) and subject to certain exemption conditions set out in the provisions of Cap. 112 can enjoy profits tax exemption on transactions in qualifying assets specified in Schedule 16C to Cap. 112 and transactions incidental to the carrying out of qualifying transactions. A publicly-offered OFC can enjoy profits tax exemption in the same manner as other SFC-authorized funds.

⁸ A share in OFC is by definition a Hong Kong stock under section 2 of the Stamp Duty Ordinance (Cap. 117). Stamp duty will not be payable on allotment or redemption of shares in OFC. Nevertheless, transfers of shares in OFC will be subject to stamp duty. If the shares in OFC are listed or traded on the Stock Exchange of Hong Kong, the OFC will constitute an exchange traded fund and the transfer of its shares will be exempt from stamp duty. Contributions or distribution of dutiable assets in consideration of any allotment or redemption of shares in OFC would be subject to stamp duty. However, if the OFC is an open-ended collective investment scheme authorised by the SFC, transfers of Hong Kong stock involved in such in-kind allotment or redemption process will be exempt from stamp duty. In the case of an umbrella OFC, each of the sub-funds will be regarded as a separate OFC. Therefore, both the conversion of interest from one sub-fund to another and transfer of dutiable assets between different sub-funds will be subject to stamp duty.

An interest in an LPF is not a share, stock, debenture, loan stock, fund, bond or note issued by the LPF, nor is it a unit under a unit trust scheme. It does not fall within the definition of “stock” under section 2 of the Stamp Duty Ordinance (Cap. 117). Accordingly, an instrument under which an interest in an LPF is contributed/transferred/withdrawn is not chargeable with stamp duty. Meanwhile, an LPF may accept capital contributions in cash or in kind as provided in its limited partnership agreement. In-kind capital contributions in relation to the transfer of dutiable assets (such as Hong Kong stock or immovable property) would be subject to stamp duty. The distribution of profits and assets of LPF to the limited partner(s) will also be permitted in accordance with the terms of the limited partnership agreement. Transfer of dutiable assets of an LPF to a limited partner would be subject to stamp duty.

INDUSTRY CONSULTATION

17. The industry has been calling for an early introduction of re-domiciliation mechanisms for OFCs and LPFs. In a public consultation conducted by the SFC for the purpose of enhancing the OFC regime in 2019, a majority of the respondents supported the introduction of a re-domiciliation mechanism for OFCs⁹. The same sentiment regarding LPF re-domiciliation was conveyed to the Government in the industry consultation on introducing the LPF regime conducted in July 2019.

ADVICE SOUGHT AND WAY FORWARD

18. Members are invited to note and comment on the proposals as set out in paragraphs 6 to 14 above. Our target is to introduce the Bill into the Legislative Council for first and second reading in the second quarter of 2021.

Financial Services and the Treasury Bureau
January 2021

⁹ Please refer to the SFC's Consultation Conclusions on Proposed Enhancements to the Open-ended Fund Companies Regime, September 2020. URL: <https://apps.sfc.hk/edistributionWeb/api/consultation/conclusion?lang=EN&refNo=19CP4>

